Understanding internationalization patterns of Zara

MSc International Business Economics

Master's Thesis

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Date of delivery: 8 June 2015

Number of pages: 243,988/2400= 101.66 pages

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EXECUTIVE SUMMARY

The following dissertation focuses on analysis of internationalization patterns of Zara, which is considered being one of the world's largest fast fashion companies. For the analysis, three internationalization patterns have been chosen: entry modes, scope and pace of internationalization. The goal of the research is to find out what factors have influenced Zara's decisions regarding market selection and choice of entry strategies, and analyze pace of Zara's foreign expansion.

The research is carried out in accordance with systems approach, thus admitting the interrelations structures might have on each other and believing that internationalization patterns of the firm can be observed from an objective perspective. At the same time, the systems approach does not denied that each party might have its own perception of the reality.

At the beginning of research, relevant theories applicable to the case study are compiled. The most prevalent internationalization theories are reviewed in order to provide a better understanding of internationalization of MNEs. Based on presented theoretical overview the conceptual framework for further research has been built. By examining interconnections between theories, two groups of factors that might have influenced Zara's internationalization patters are identified. The first group includes firm's characteristics that might have an influence on Zara's international expansion like market experience, firm's specific advantages and strategic objectives. Other group of factors consists of host market factors that might have an effect on internationalization patterns. From this perspective, following factors are chosen: psychic distance from home to host markets, attractiveness of markets, particular business and institutional conditions.

At the end, analysis of the most important markets on a regional base is performed in order to reveal main factors influencing Zara's internationalization choices in terms of markets and entry modes. Additionally Zara's pace of internationalization is analyzed. Finally, the comparison with the main competitors is carried out in order to compare Zara's business model with competitors and underline Zara's competitive advantages that helped to become one of the world's leading fashion companies.

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LIST OF ACRONYMS

AR- Annual Report

B2C- Business to Customer

EP- Eclectic Paradigm

EU- European Union

F- Franchising

FDI- Foreign Direct Investment

H&M- Hennes and Mauritz

IBE- International Business Economics

IT- Institutional Theory

JV- Joint Venture

LOF- Liability of Foreignness

LOO- Liability of Outsidership

MNC- Multinational Corporation

MNE- Multinational Enterprise

OLI- Ownership, Location, Internalization

PD- Psychic Distance Theory

ROE- Rest of Europe

ROW- Rest of the World

TCE- Transaction Cost Economics

TCT- Transaction Cost Theory

UAE- United Arab Emirates

UM- Uppsala Model

USA- United States of America

WHS- Wholly Owned Subsidiaries

ACKNOWLEDGMENT

"It always seems impossible until it's done"

Nelson Mandela

The following dissertation has been prepared as a part of 10th semester final exam in MSc in International Business Economics (IBE) at Aalborg University.

The research paper would not be possible without the several people support. It would not be possible to accomplish the dissertation without the hard work and contribution of both authors. Furthermore, we would like to extend our sincere thanks to our family members for provided reliance and understanding.

Moreover, we would like to express our gratitude to Aalborg University and International Business Centre particularly for given opportunities and assistance. We would like to thank Birgitte Krogner for providing an administrative support during the studies.

Our special thanks goes to associate professor Svetla Trifonova Marinova for being very supportive and providing us with valuable guidelines necessary for writing the dissertation.

INTRODUCTION

"What you wear is how you present yourself to the world, especially today, when human contacts are so quick. Fashion is instant language." *Miuccia Prada*

The focus of this dissertation is to analyze the internationalization patterns of fashion companies using Zara as a platform for the research.

Zara is one of the biggest and most successful fashion retailers in the world. However, there is lack of extensive studies about the firm in English. The majority of studies are shallow and do not contain sufficient empirical data to support research findings. Therefore, this dissertation aims to address the gap in the literature by investigating Zara's internationalization patterns in different markets.

The dissertation will start with a brief overview of evolution of fashion industry and description of fast fashion business. This will provide a reader with valuable information about the industry and will give an insight in the main characteristics common to fast fashion companies as Zara. The fashion industry overview will be followed by the problem formulation and development of research questions. Afterwards, different theories describing internationalization process will be reviewed. Based on findings from relevant theories, a conceptual framework for the dissertation will be developed. The theoretical part will be continued with description of methodological standpoints and selection of appropriate methodological approach. After that, appropriate methods for conducting the research will be selected.

The analysis chapter will start with a presentation of Zara's business model and brief overview of its historical evolution. Afterwards, the key aspects of Zara's internationalization will be reviewed by describing the firm's expansion into several markets. The motives and factors that might have an influence on Zara's internationalization patterns, in terms of market selection and choice of entry strategies, will be analyzed. The chapter will be continued with analysis of Zara's pace of internationalization. Finally, the comparison between Zara and three of its main competitors will be performed in order to underline Zara's competitive advantages.

At the end, findings from analysis of Zara's internationalization patterns will be discussed and compared with the most widespread internationalization theories. The chapter will be continued with discussion of main limitations of the research. At the end of the dissertation, the key findings will be summed up in the conclusion part.

OVERVIEW OF FASHION INDUSTRY

This chapter contains the description of the main characteristics of the fashion industry by explaining historical evolution of the industry. The common features characterizing the fast fashion businesses are presented. This chapter provides valuable information, thus helping to understand better common characteristics of fashion companies and development of the industry over time.

Evolution of fashion industry

Fashion and the fashion industry are relatively new phenomenon. Until the middle of 19^{th} century, clothes were custom made for individuals. In the beginning of 20^{th} century, the industry grew rapidly thanks to rise of new technology and shift from handmade to mass production, when clothes were produced in standard sizes and sold at fixed prices. First, the fashion industry developed in America and Europe, with a time it has spread all over the world. Nowadays the fashion industry is a global, internationally integrated industry with clothes designed in one country, production facilities located in another country and consumers coming from a third country (Major, 2013).

In the 1980s, it was assumed that only US and European companies possessed necessary capabilities to produce high quality garments and tailored clothes. Thus, countries outside US and Europe were involved only in medium or low quality item production. Moreover, it was believed that firms outside US and Europe have long lead times and require large production runs. Partially industrialized countries[1] were not technologically developed enough and there was no indication that this could change in the nearest future, because sophisticated computer-aided systems were too expensive for those companies (Tokatli, 2008). In contrast, it was thought that only companies located in New York, Paris, Milan and London possessed all endowments to design and create high-end fashion clothes maintaining high flexibility (Green, 1997).

[1] countries whose economies are partly industrialized such as China, India, Brazil, Mexico, Argentina, Turkey, Morocco etc.

In the late 1980s, retailers changed their strategy and started to offer greater variety of clothes and more fashionable garments in order to exploit favorable opportunities by targeting new market segments (Zeitlin and Totterdill, 1989). This led to increased demand for better quality goods and fashionable garments, thus creating opportunities for suppliers located in the partially industrialized countries. As a result, in the 1990s several countries such as China, Turkey and Morocco obtained knowledge and competence to produce high- quality garments at the same time maintaining required flexibility, thus demonstrating that high- quality items can be manufactured also outside US and Europe. Chinese and other low- wage country firms started to produce counterfeit versions of luxury brand goods. Some producers were offering so called “super fakes” which were not possible to an untrained eye to distinguish from original ones (Tokatli, 2008). Moreover, suppliers from the partially industrialized countries went a step forward and created their own teams of designers, thus becoming more competitive. As examples can be mentioned the following companies: Bair with their own garment designers, Mexican jean producer Gereffi and clothing company Tawari from India (Tokatli, 2008).

In the end of 1990s, the new fashion culture emerged focusing on trends, thus improving the competitive advantage of companies from Morocco, India and Turkey and putting in worse position producers of luxury brands. Despite of slow market growth, companies like H&M, Mango and Zara doubled their sales between 1998- 2002 (Tungate, 2005). At that time consumers were encouraged to make their individual style by combining designers’ items with young, unknown designers’ items, which were trendy, but inexpensive. Thus, customers became their own style creators. This trend facilitated dramatic so-called fast fashion[2] sales increase between 2001- 2005 (Tokatli, 2008).

The partially industrialized countries became not only a home for manufacturing sites but also important markets for fashion brands. A number of luxury brand and fast- fashion stores have been opened in China, Brazil, Russia and India. These countries have become attractive because of high population and growing middle class. Moreover, these countries have become a destination for offshoring of manufacturing activities. The Italians started to set up production sites in China for last 30 years. Nowadays, several luxury “made in Italy” brands are entirely produced in China. The country is also a master place for copying famous brands in a subtle and competent manner (Reinach, 2005). The collapse of the Soviet Union in 1991 facilitated illegal

[2] Description of the fast fashion is presented in the next chapter

trade with Russia. The Turkish clothing companies took advantage by selling counterfeit versions of prestigious brands to the Russian market and became experienced producers of replica clothing (Yukseker, 2007). Nevertheless, Chinese and Turkish companies parallel to the manufacturing of other brands have launched their own brand production (Tokatli, 2008).

From January 2005, all import quotas in the textile and clothing industry have been removed. The abolition of quotas is considered a main driver for clothing sector development, opening European, American and Canadian markets for big exporters like China and India and creating challenges for European countries to keep the advantage gained in international markets (Lopez and Fan, 2009). However, globalization has made supply chains broader and more international. Nowadays many companies are outsourcing most of the production activities to suppliers located in low cost countries (Martínez et al., 2015).

In general the fashion industry is characterized by price- sensitivity, short product life cycles, great varieties, impulsive and unpredictable demand (Sen, 2008). Traditionally, the supply chain is organized to prepare the necessary goods for two campaigns: Spring- Summer and Fall-Winter. The production is based on demand forecasts and all activities integrated in accordance to two key processes of value chain: new collection development and order fulfillment (Martínez et al., 2015).

Fast fashion

In order to maintain competitive advantage and adapt to the dynamic market, some fashion companies have implemented the fast fashion concept (Franks, 2000). Fast fashion is defined as "*a business strategy that aims to shrink the processes involved in the buying cycle and lead times for getting new fashion products into stores, in order to satisfy consumer demand at its peak*" (Barnes and Lea-Greenwood, 2006, cited in Ziyind, 2015, p. 217). Several apparel retails have implemented this concept, such as Zara, H&M, and Benetton. The business concept of fast fashion retailers is based on three pillars: short production and distribution time; highly fashionable design and affordable price (Ziyind, 2015).

In comparison to haute couture[3] and ready-to-wear[4] retailers, fast fashion retailers do not invest heavily in the design work of clothing. Fast fashion retailers attend fashion shows, collect data from customers, and transfer these trends into clothes that are put for sale almost immediately (Ziyind, 2015).

Prerequisites for super-fast responsiveness are short product development cycles, rapid prototyping, production in small batches and large variety. The main objective is to offer the latest designs in limited quantity thus creating sense of exclusivity and urgency. In order to secure frequent deliveries, fast fashion retailers must have very fast and responsive supply chain. Customers' demands have to be connected with activities of upstream supply chain, such as design, procurement, production and distribution. Therefore, information infrastructure should be developed to ensure quick transfer of information from trend spotters and customers to designers and people working in production sites. By producing in small batches, offering great variety of styles and ensuring quick deliveries, fast fashion retailers most of their clothes sell for the full price and protect themselves from overstock of seasonal collection items (Ziyind, 2015).

Most of the fast fashion firms are publicly traded companies. Thereof, their success is measured by performance of stocks. This means that retailers have to ensure continuous development. Therefore, fast fashion retailers strive to increase rapidly the number of stores all over the globe thus maintaining high growth rates.

[3] The term haute couture refers to expensive, fashionable clothes produced by leading fashion houses

[4] Ready-to-wear refers to factory-made clothing made in standardized sizes and sold in finished condition

RESEARCH PROBLEM AND RESEARCH DESIGN

Problem formulation

In this dissertation, we shall concentrate on the analysis of the internationalization patterns in the fast fashion industry through focusing on a company that has successfully expanded abroad over the last 30 years. The goal is to understand what activities the company is performing consistently while expanding its operations in international markets. Along with discussing different patterns, the authors are aware of different aspects that define each pattern. Therefore, the study is focused to the following problem statement:

> ***What internationalization patterns are used by multinationals in the fashion industry: The case study of Zara***

Patterns of internationalization can be perceived as the choice of international market, speed of foreign expansion and the choice of entry mode. The pace of company´s internationalization derives a pattern of international expansion and subsequently affects the choice of market and entry mode.

In addition, attention is drawn toward discussing the pace and scope of internationalization.

Considering the above mentioned, the dissertation attempts to answer the following research questions:

- What are the motives behind Zara's market selections?
- What factors have influenced Zara's entry mode choice?
- What is the pace of Zara's foreign market expansion?

Problem justification

"Companies that will not adapt to the new global realities will become victims of those that do."

Theodore Levitt, Harvard Business School

Nowadays more and more companies are operating internationally, and in some cases even globally. At the same time, the significance of domestic and, subsequently foreign-based transnational corporations is increasing. Therefore, having in mind its importance, the internationalization process is not only focused on answering why companies are expanding abroad, but more how they should do that. One of the main reasons for internationalization can be defined as company´s need to remain competitive in the respective environment.

Even early works of different economists were deliberating the need for internationalization. Adam Smith as one of the pioneers was explaining internationalization, although from national level (1776).

Based on the increased importance of company´s expansion abroad, in this study, the authors are aiming to understand how companies in the fashion industry are internationalizing using the case company as a platform.

Furthermore, the study is concentrated on understanding the patterns that are used in the expanding process. In order to be able to define the relevant patterns, the authors will review different relevant theories, which are discussing internationalization process.

Subsequently, in order to define the adequate patterns, the problem in focus has been broken down into several research questions, which are aiming to realize the motives, and factors that influence market selection, entry mode applied, as well as the pace of internationalization. In this thesis, authors will address important aspects of the case company´s expansion based on the theoretical discussion as well as the case company internationalization in the fast fashion industry.

Design of dissertation

In this paragraph, the design of the dissertation is presented. The thesis project is structured in a gradual manner. The logical sequence of information helps the reader to understand the phenomenon in focus and gradually moves to discussion and conclusions chapters. The structure of the dissertation is presented in following figure:

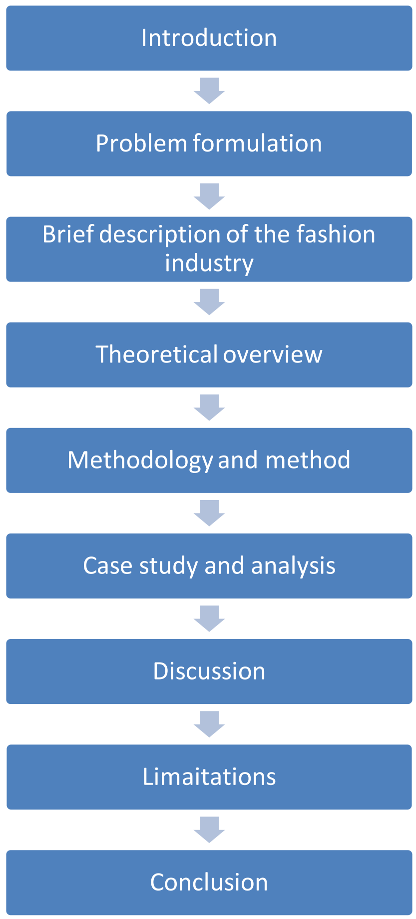

Figure 1- Structure of the dissertation (source: authors' creation)

In the beginning of the project, introduction will be placed. The introduction part will be followed by formulation of the research questions. After problem formulation, a brief description of the fashion industry will be presented. A short insight in the fashion industry helps to understand common characteristics of the industry, the evolution of the industry and, thereof, the case company. Afterwards, the relevant theories will be reviewed and conceptual framework created. In the next chapter, the main methodological concepts will be introduced. Based on the root assumptions of internationalization theories and personal beliefs of authors, the appropriate methodological approach for the dissertation will be chosen and used research methods will be presented. Later on, case study and analysis will be carried out. At the end of the research paper discussion, limitations and conclusions will be presented.

LITERATURE REVIEW

Multinational enterprise (MNE): the fundamentals of internationalization

In order to understand the concept of internationalization and different phases of internationalization process, its fundamental, multinational enterprise needs to be defined. Nowadays, multinational corporation (MNE) can be defined as enterprises engaged in foreign direct investment (FDI), with an established value adding chain in more than one country (Dunning, 1993). The general understanding is that MNEs are "*enterprises which own and control assets in multiple countries*" (Buckley and Casson, 1976). This can be perceived as possessing an ownership over the business through ownership of assets and activities in more than one country.

Such type of enterprise is characterized with two items:

- Economic production is coordinated within different enterprises, where coordinating issues are internalized inside single firm structure;
- Coordination of economic transactions goes beyond national boundaries.

Multinational corporations are created as an answer to market imperfections. According to Hymer (1976), MNEs are built with the purpose to help overcoming market imperfections.

Once when they are established, MNEs can ease allocation of resources and lower the costs of international activities. With increased globalization, the scope of internationalization has been changing. The main focus is still on MNEs, and traditional theories of internationalization were focused on conducting production across borders and establishing foreign direct investments.

At the same time more recent theories are defining internationalization as a complex process in which firms are driven by investments and therefore, their involvement, resources and strategies are adjusted within international operations (From international trade to firm's internationalization, 2010).

Subsequently, multinational corporations or companies capable to derive a significant percentage of revenue from operating abroad can be distinguished in several categories:

- Multinational corporation operated in one country, with high presence at home market and decentralized;
- Multinational corporation with aim to achieve cost advantage through organizing production facilities where low-cost resources are available;
- An international company built on the corporation's technology replicated from the parental company (Organizational forms for MNCs, 1993)

The multinational corporation in focus: Zara cannot be clearly classified in any of these categories. With strong presence at home and numerous international markets, the company is aiming to obtain a cost advantage while replicating business model built at home. Therefore, it represents a certain combination on mentioned categories.

Internationalization process: definition and different aspects

Although the concept of internationalization has been broadly used, only few researchers have tried to define the meaning of the term. According to Piercy (1981) and Turnbull (1985), internationalization is the outward movement of a firm's activities. Whereas Welch and Luostarinen (1988, pp. 36) define internationalization as "*the process of increasing involvement in international operations*". Such a process brings changes in a company, therefore, the concept of internationalization can be perceived as an experience, which subsequently changes the company's attitude towards further internationalization (Johanson & Weidersheim, 1975).

The several mentioned definitions are reviewing different aspects of the internationalization process, and yet they can be successfully combined into one by describing internationalization as a process of cross national operations' involvement, equally demanding the adaptation to foreign markets and resources' commitment, affecting the current attitude of company and future internationalization's decisions (Hanf & Pall, 2009). From the perspective of international activities and degree of involvement, two types of internationalization can be distinguished.

The first one is inward internationalization, where a company is primarily focused on activities on the home market. Moreover, it means that companies are using the knowledge about foreign markets with the goal to satisfy home market demand. Outward internationalization is an opposite process where companies are using knowledge gained at home in order to satisfy host market demands. Outward internationalization can be achieved through different operational modes, which are aiming either to export or produce company's products (Hanf & Pall, 2009).

The process of internationalization can be further described having in mind different dimensions of multinational corporations' activities. MNEs have different approach to internationalization in terms of pace, scope and rhythm of foreign expansion. Pace refers to the speed of expanding abroad. It is a time based parameter that indicates how much time passes before firm achieves certain objective, for instance, how many foreign expansions firm undertakes during the certain period of time (Wagner (2014) cited in Lin, 2012, pp.48). Scope of foreign expansion describes the geographical dispersion of internationalization. This dimension describes the number of countries firm operates (exports, invests, runs production facilities or has sales subsidiaries). The third dimension of foreign expansion is rhythm. This dimension describes "*the regularity of the process, or the rhythm at which new subsidiaries are established*" (Lin, 2012, pp. 48). Firms may establish subsidiaries abroad on regular bases, for example, one subsidiary every year, while another company may prefer irregular expansion by alternating rapid expansion periods with long periods of inactivity.

This shows that firms might have different approaches when internationalizing. It is important to understand dimensions described above and their influence on internationalization patterns firms use when expanding overseas. In the next chapter, the most common internationalization patterns will be reviewed.

Internationalization patterns

When a company decides to expand abroad and step up into international activities, a certain pattern of consistent activities needs to be followed over the time. Those activities, as well as pattern can be defined as internationalization development strategy of a company. According to Jones and Coviello (2005), internationalization patterns present behavior on company's level, which can be evidenced at specific points of time, and goes beyond national borders. Furthermore, three main internationalization patterns can be distinguished: gradual internationalization, radical internationalization and late radical internationalization. The choice of internationalization patterns that a company is applying depends on which internationalization stage the company is at. Therefore, at the initial internationalization stage, characterized with low level of commitment, gradual internationalization patterns are applied. In this stage, companies gradually gaining knowledge about foreign markets and subsequently raise the level of commitment on host markets. Furthermore, in this stage, a company is internationalizing in a slow pace, and in internationalization scope are markets at lower psychic distance from home market. Due to previously emphasized low level of commitment in host markets, export is widely used entry mode attributed with low risk and control over the host markets' operations. The Uppsala model that is particularly analyzing dependencies between companies' level of knowledge and commitment towards foreign markets will be reviewed subsequently in the dissertation.

Radical internationalization patterns can be perceived through the born global company concept. According to Oviatt and McDougall (1994), born global company is an organization aiming to capture significant competitive advantage by using resources and selling products or services in numerous countries. In general, born global company sees the globe as marketplace and starts with internationalization within three years of establishing. This can be understood as a part of company's subsequent internationalization stage. The radical internationalization patterns are significantly different from the gradual internationalization patterns. This is mainly due to the fact that born global are internationalizing in a fast pace, as they perceive the world as holistic market. In addition, the scope of expansion is very wide, as the company involves in market penetration by neglecting the psychic distance between home and host markets (Bell et al., 2003).

The late radical internationalization patterns are applied in companies which are existing at home market for a longer period of time and do not possess an interest for international expansion until some significant event occur. Those companies are known as born-again global, and in moment when the decision for market expansion is made, company possesses relevant resources that can be used for the expansion (Bell et al., 2003). In general, born-again global are radically expanding in the initial internationalization stage, as once when the reason for internationalization appeared, the expansion process is radical and committed. In addition, this means that scope of internationalization is wide, due to several markets' expansion at the same time, but the pace is rather slow, as there is no time limitation for the beginning with internationalization activities. The level of commitment is high and therefore investments' involvement can be through more sophisticated operational modes.

After the brief overview of literature on foreign expansion patterns, it can be inferred that most often authors refer to two main parameters that characterize the patterns of internationalization: pace and scope. Additionally, researchers talk about market commitment in terms of entry modes. In this dissertation, the authors have chosen these three parameters for analysis of internationalization patterns of Zara. Therefore, the literature review is designed to find out the factors that might have an influence on pace and scope of internationalization and choice of operational modes. In this chapter the most common internationalization theories and concepts will be presented.

Internationalization theory

The scope of internationalization theory is focused on multinational enterprise and its interaction with the external environment. Internationalization theory is also directed on internal organization of MNEs, with the goal to realize the way of functioning and reasons behind a firm's decision to expand the activities behind the border (Rugman, 1981). According to Rugman (1981), it can be perceived as noticeable movement of firm's activities.

Since internationalization theory is reviewing both external environment interaction and internal organization, the focus here is on inward and outward growth of companies. As mentioned, the scope of internationalization theory is the behavior of MNEs. While interacting with its environment, multinational enterprises are building networks. Those networks possess various strength levels between subsidiaries. Efficiency and functioning of MNE can be evaluated through internationalization theory analyzing benefits of established interdependencies in different countries. In other words, the boundaries of firm are determined by the costs, and further internalization of markets is defined by benefits.

Over time, internationalization theory has examined different aspects of multinationals' expansion, but the main three discussions remain the same:

- What are the motives of companies to go abroad?
- Which factors enable them to do so?
- What were the reasons behind different forms of investments? (Rugman, 2008).

Due to the internationalization process' complexity, consisting from significant number of activities, related with geographical distance and intensity of integration, several internationalization theories can be distinguished. For the purpose of understanding the underlined issue and further development of the project, authors decided to review the following: Modes of market entry, Transaction cost theory, Uppsala model, The eclectic paradigm, Institutional theory, liabilities of foreignness and outsidership, literature on pace of internationalization and psychic distance aspects.

Modes of market entry

In the following chapter several types of entry modes will be analyzed. The goal is to realize their main characteristics but also to understand in which phase of business development and internationalization activity, company should apply mentioned entry options.

Along with decision for expansion on particular market, company needs to consider which entering strategy will use. The main difference between several modes is level of risk and control. Additionally, required committed resources and possible return on investment have to be taken into consideration. Subsequently, entry modes with lower intensity are resulting with lower level of risk. Based on complexity of business arrangement and level of risk and control, there are several types of entry modes on foreign market:

- Export modes: exporting (indirect, direct)
- Intermediate entry modes (licensing, joint venture, merger, strategic alliance)
- Wholly owned modes/subsidiaries (acquisition, greenfield investments)

Exporting. This type of business arrangements represents the traditional way of reaching different markets. According to this mode, there is no need for investment in production facilities on focal market, as the subject of export does not necessarily need to be produced on the same. This type of expanding is suitable when production is not very large, and location of production in home country creates additional cost advantages.

The biggest advantages of exporting are accessibility of market in short term, importers on foreign market can be attentively chosen, there is no risk for exporter. Furthermore, the company still has full control over the production and low initial investments. At the same time, the main disadvantages are low degree of control over marketing and sales, high risk of wrong choice of distributor that can affect the brand image of product and potential costs of trade barriers.

The disadvantage in regard with costs and trade barriers can be through high transportation costs and different tariffs and quotas (Reynolds, 2003).

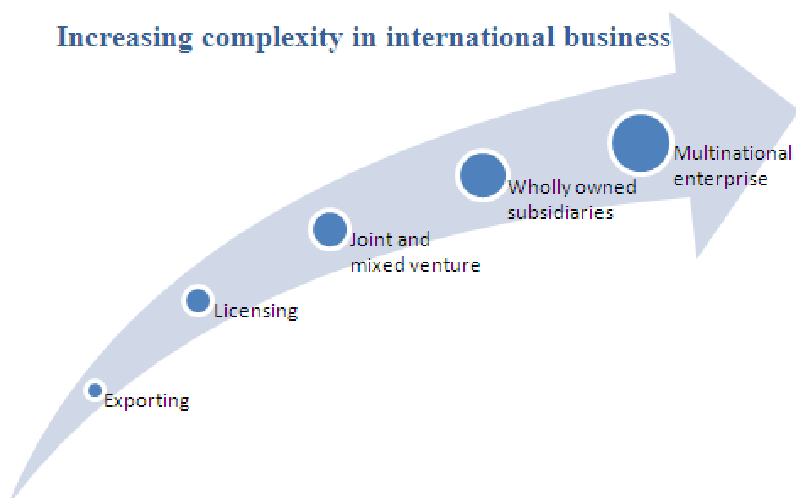

Figure 2- Operation modes in international business (Source: International Business Information, 2015)

Licensing. Licensing is a type of entry mode where a home country manufacturer (licensor), leases technology or brand name to a manufacturer in a foreign country (licensee) for a certain amount of money (fee). This type of entry mode presents a less costly way of expanding, where the licensor can chose a location to provide with the rights (technology or brand name) and earn the revenue. This can be achieved through assessing markets with potential and without formed barriers on foreign investments. Besides that, through this type of arrangement, a licensor can avoid trade barriers, and licensee can ensure access to the know-how. Also, the level of risk is low if there is established property rights regime. The main disadvantages are missing control over the licensee's operations, and possibility of creating a new competitor. The main challenge for licensor can be transfer of knowledge, as well as controlling of transferred know-how outcome (Hollensen, 2011).

Joint venture. When two or more firms are establishing a new business unit, independent from the parent companies, that type of entry mode is called joint venture. The joint venture can be equal and non-equal. The main characteristic of a joint venture is shared ownership and risk. Also, this type of business arrangement is suitable if there are expectations for mutual benefit in long-term. For the focal company joint venture brings additional value in creating image in host country. Still, this type has some challenges. The main are: lack of partners full control, potential conflicts and loss of knowledge, decision making can be delayed and slowed down (Subhadra, 2003).

Mergers. The business arrangement where two or more companies are joining on equal basis, sharing their resources and capabilities in order to improve competitiveness and strength the position on the market, is known as merger. Mergers are long-term organized business units, established with a goal to increase the revenue and market share, to enlarge economy of scale and to reduce the costs (Hitt, 2009).

Strategic alliance. Strategic alliance is cooperation between two or more companies established with the purpose to achieve the larger goals. This is non-equity type of mode where partners share risks and knowledge not on the same level. The main characteristics are: developing of new products through interaction with different industries, challenging the technological development, strengthening competitiveness towards multinational companies (Bartett, 2009).

Acquisitions. The purchase, when one company takes over another is called acquisition. Usually, such purchase is 100% of assets or ownership equity. Acquisitions can be distinguished into public and private, based on listing of target's company on public stock market. The goal of acquisition is synergy achieving. This type of business arrangement is particularly suitable for developed market, where the target-company is capturing strong position on the host-market. Through the acquisition, acquiring company can achieve the following: gain the acquired company's knowledge, keep the control over the technology and foreign operations. At the same time, the main challenge acquiring company might have is regarding the value estimation of acquired company (Bartett, 2009).

Greenfield investments. Greenfield is very complex and costly establishment of wholly owned subsidiary, where business activity needs to be built from the scratch. In this type of business agreement company has a full control. However, this entry mode is very risky because a new business unit has is established in another country. Moreover, this process can be time consuming. This is primarily resulted by a need to build distribution networks and new operations. For the Greenfield investment one of the challenges can be implementing of competitive strategy in the particular market (Hitt, 2009).

Transaction cost theory

Transaction cost theory (TCT), or transaction cost economics (TCE), has been broadly used in the analysis of different strategic and organizational issues. The theory has been applied when studying firms' vertical integration options, grounds for acquisition and choice of hybrid governance forms (Martins et al., 2010). Therefore, it can be inferred that TCT tries to explain the existence of firms, reasons for expansion (including expansion across the borders) and sourcing out activities to third party companies.

Ronald H. Coase (1937), the founder of the transaction cost theory, stated that there are costs associated with conducting "*transactions through the market and that these costs can be reduced through mechanism other than market*" (Coase, 1937 cited in Martins et al. 2010, pp. 6). Transaction costs represent costs of the price mechanism. Coase claims that there is no market mechanism without costs. Transaction costs include costs of drafting, negotiating and safeguarding the exchange of goods; thereof, constitute important part of total costs of a firm. According to Williamson (1985) transaction costs can be divided into ex- ante costs and ex-post costs. The ex-ante costs include costs of searching for information, writing and negotiating agreements and costs of safeguarding agreements. The ex-post costs comprise costs of evaluation of input, measuring the output and monitoring and enforcement.

The main idea behind the theory is that firms try to minimize costs of exchange. According to the TCT, a firm will expand its activities as long as those activities can be carried out within the company at lower cost than by outsourcing activities to the external parties in the market (Coase, 1937). Furthermore, the TCT suggests internalizing activities inside a firm when there is some form of market failure, for instance failure of intermediate inputs (Martins et al., 2010). According to the theory, a firm is viewed as a hierarchy that adds value by minimizing transaction costs. The advantage of the theory is that it focuses not only on two polar governance forms hierarchy and market, but also on the hybrid modes and long-term agreements (Martins et al., 2010). Thus, three forms of transaction governance can be distinguished: market, hierarchy and hybrid. The market transaction governance refers to a simple mode of exchange between independent parties based on the price mechanism. Hierarchy governance is more complex mode representing transactions between parties under unified ownership with already established hierarchy (Williamson, 1981). The hybrid form comprises "*long-term contractual relations that preserve [parties'] autonomy, but provide added transaction-specific safeguards as compared with the market*" (Williamson, 1996, pp. 378)

The TCT is based on several assumptions that explain why firms may perform activities more efficient comparing to markets (Williamson, 1985). The firm will choose the governance form that will minimize transaction and production costs. The transaction costs depend on the following factors: opportunism with guile; bounder rationality; asset specificity; uncertainty and transaction frequency.

Opportunism with guile refers to the self-interested action of human beings and assumes that an individual may engage in delusive behavior. Therefore, parties draft contracts, in order to try to protect themselves from costs caused by opportunistic behavior. However, agreements cannot be written perfectly to anticipate and prevent all forms of unethical behavior. According to Williamson (1985), the opportunism is about the motives of individual behavior and is one of the central factors in the TCT because with no opportunistic behavior it would be possible to design perfect contracts and enforced them with no additional cost. In such ideal situation, there would be no necessity for other governance forms rather than the market (Martins et al., 2010).

The TCT assumes that human beings are **boundedly rational**. This implies that individuals do not have perfect information and, therefore, they are "*intendedly rational, but only limitedly so*" (Simon, 1961, cited in Williamson, 1985). Individuals are not able to process large amounts of information, therefore cannot precisely predict what will happen in future. Humans try to make rational decisions as much as possible, however rationality of individuals are limited by "*their imperfect cognitive abilities and in conditions of imperfect information*" (Martins et al., 2010, pp. 8).

According to Williamson **asset specificity** are "*durable investments that are undertaken in support of particular transactions, the opportunity cost of which investment is much lower in best alternative uses or by alternative users should be original transaction be prematurely terminated*" (Williamson, 1985, pp. 55). Asset specificity includes investments in both physical and human assets related to the particular trading relationships (Pawlicz, 2011). Williamson claims that "*transactions that are supported by investments in durable, transaction-specific assets experience 'lock in' effects, on which account autonomous trading will commonly be supplanted by unified ownership*" (Williamson, 1985 pp. 53). This implies that high asset specificity leads to internalization (vertical integration), whereas low asset specificity stimulates to choose market governance forms.

Williamson distinguishes between six types of asset specificity: site specificity, physical asset specificity, human asset specificity, dedicated assets, brand name capital and temporal specificity (Williamson, 1989: 141-142). *Site specificity* refers to an investments made in a site that is close to the buyer or seller. Specificity rises when assets are not movable or can be moved at a great cost. *Physical asset specificity* includes investments in physical assets that are designed for a single purpose or relates to a particular trading partner. *Human asset specificity* relates to highly specialized know-how, experience that is not transferable due to its limited applicability in other situations. *Dedicated asset specificity* refers to investments in assets that has been acquired for a single purpose or in connection with a certain long-term agreement, therefore, cannot be used for other purposes. *Brand name capital* is related to reputation investment, therefore, the TCT suggest do not to outsource activities if that can damage a brand or reputation. Temporal specificity is associated with "*assets where timing and coordination of activities is critical*"

(Pawlicz, 2011, pp. 9). Assets can have a specificity that they may belong to multiple groups; therefore, the typology proposed by Williamson is frequently omitted.

Uncertainty in context of TCT focuses on behavioral uncertainty and limited access to information that might increases transaction cost in the market. Quite often the firm does not have access to all data about past, current and future state. Moreover, individuals might engage in opportunistic behavior and it is not possible to determine whether partner will act in self-interest. Therefore, parties prefer to enter into agreements (Williamson, 1993).

Frequency of transactions is related to dynamic of exchange and determines whether costs of certain governance forms are justified. The degree of frequency might be from occasional to recurrent. If exchange is occasional, then market governance mode is preferred. More frequent and/ or large volume transactions on the other hand justify costs of the firm governance form (Williamson, 1985).

Limitations

Despite fact that the TCT has been broadly used in the analysis of economic factors of internationalization and has gained widespread acceptance in the internationalization literature, the theory has been criticized a lot. Some authors claim that the main assumptions of the theory are flawed (Martins et al., 2010). Granovetter (1985) criticize the TCT "*for ignoring the contextual grounding of human actions and therefore presenting an undersocialized view of human motivation and oversocialized view of institutional control*" (Ghoshal and Moran 1996, pp. 14-15). In order to limit opportunistic behavior, Williamson suggests choosing a control hierarchical governance mode. From such undersocialized view on individuals, arise the shortcomings of the TCT. Jones (1998) claims that the same conditions may push individuals to behave differently- some could act opportunistically, others may lead to trust and cooperation. The theory focuses only on the costs of transactions and ignores the benefits of transactions (Boudreau et al., 2007). The TCT fails to explain how opportunistic behavior can be reduced via alternative governance structures (Ghoshal and Moran, 1996).

The assumptions of bounded rationality and uncertainty also have been widely criticized. According to Martin et al. (2010), the TCT views uncertainty as a threat that must be managed via governance forms that will allow to reduce transaction costs. However, Jones (1998) argues that bounded rationality and uncertainty should not be viewed as a problem, but rather opportunity that needs to be exploited. Jones states that "*advantages of organizations over markets may lie in leveraging the human ability to take the initiative, to cooperate and to learn; it may also rely on exploiting the organization's internalized purpose and diversity to enhance both learning and its use in creating innovations and purposive adaptation*" (Jones, 1998, pp. 42). Moreover, many researchers claim that the TCT ignores environmental uncertainty and past dependences (Zajac and Olsen 1993; Calof and Beamish 1995; Ramanathan et al. 1997; Zafarullah et al. 1998; Gulati et al., 2000 cited in Schwens and Kabst, 2009).

The TCT avoids operationalizing the measurements of transaction costs themselves (Boudreau et al., 2007). Moreover, according to Dow (1987) it is pointless to compare transaction cost under different governance modes because the form of governance changes the nature of transactions.

Uppsala model

The Uppsala model is one of the most reviewed theories in international business, with the great impact on researches dealing with explanation of companies´ internationalization process. According to Johanson and Vahlne (1977), authors of the model, firms are internationalizing gradually. They were claiming, based on the observed acting of Swedish companies, that firm's penetration on particular market is determined by the level of knowledge about that market. In other words, the prerequisite for beginning of internationalization process for a firm is gathering experience on the domestic market. Johanson and Vahlne (1977) were arguing that after saturation on the domestic market, companies were starting to expand their activities via simple business arrangements such as export or dealers engagement, until they are mature enough to establish complex business model such as foreign direct investment.

Still, the decision for greater business initiative such as foreign direct investment is predetermined with "*a sufficient level of knowledge*" (Hollensen, 2007).

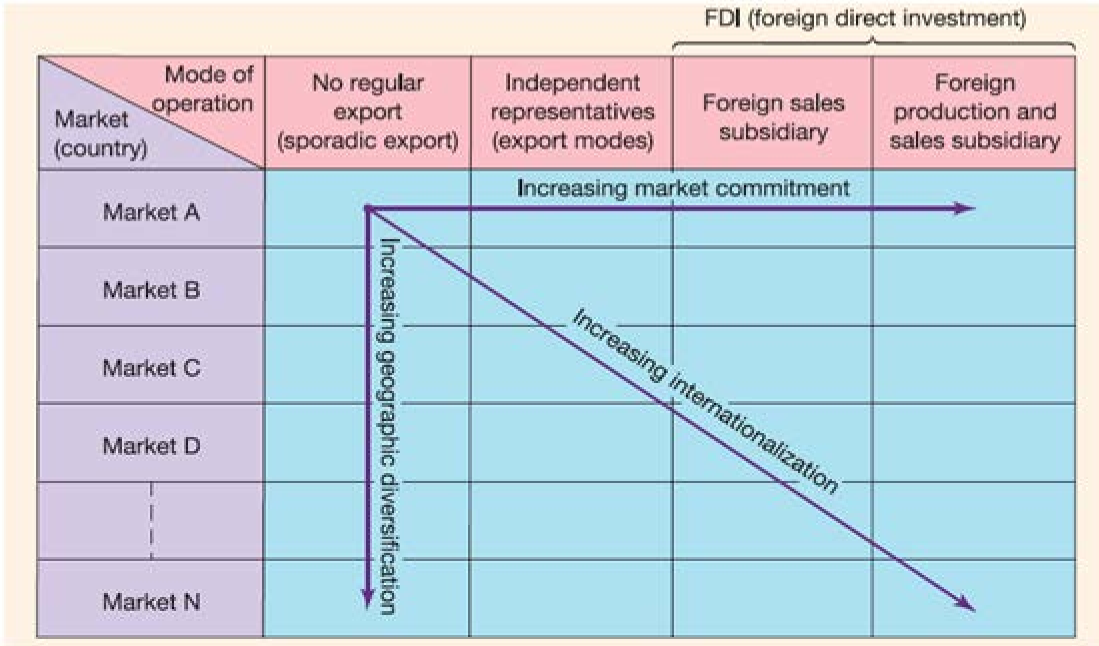

Figure 3- The Uppsala internationalization model (Source: Hollensen, 2011)

Another characteristic of this model is firm's entering on markets with lower psychical and cultural distance. The authors claim there is better understanding of environment and fewer risks on market with lower distance.

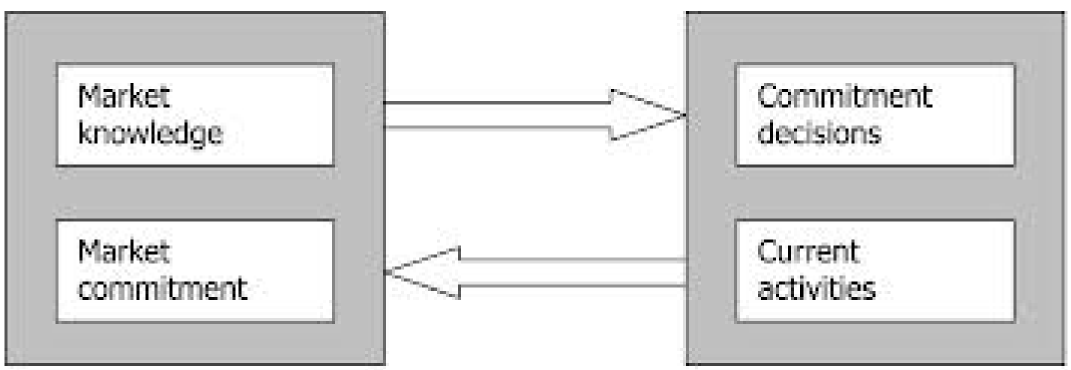

Figure 4- The Uppsala process model (Source: Johanson and Vahlne, 1977)

Cultural differences have to be taken into account when considering company's performing of international activities. Furthermore, lessons learnt and knowledge gained on market with lower psychical distance, according to Uppsala were a solid base for future decision making and penetrating on markets with higher distance.

The Uppsala model presents strong connection between market knowledge and commitment: the greater knowledge about market results with the stronger commitment decision. In other words, sufficient learning and practice on particular market will ensure higher level of company's commitment.

Performance of company's activities is strongly affected by the level of commitment (Johanson and Vahlne, 1977).

Limitations of Uppsala model

In spite of great contribution Uppsala model had on international business, this model experienced several limitations. In the following chapter those will be emphasized. Due to widely present globalization and environment characterized with faster changes, nowadays companies cannot allow expanding in slow and incremental steps. This can be limiting factor having in mind Uppsala model is developed more than 30 years ago.

Nowadays, owing to rapid development of technology and constantly changing business environment, companies need to adjust faster to consumer behavior and existing market situation. Hence, neglecting external factors, such as existing competitions and market potentials, and focusing only on internal factors within the company, as knowledge gathering is, represents the biggest limitation of Uppsala model (Hollensen, 2007). According to Johanson and Vahlne, company's internationalization process always starts with sporadic export and developing towards collaboration with independent representative. Other modes of entering markets, such as franchising and licensing, characterized with less risk and low levels investment are neglected (Doole and Lowe, 2008). Uppsala authors' statement that, in order to enter a new market company needs to have sufficient level of knowledge about particular market was also criticized. If company perceives a risk of not being present on particular market higher than risk of entering without the sufficient knowledge, company will invest. Learning process does not have to progress in incremental steps.

According to Forsgren (2002), organizational learning can be conducted in many ways. One of the ways he is advocating, is learning from the network company belongs to. Through the participating in established network, company can learn from other members. Alternative could be hiring people with knowledge about the market, or acquiring company that possess the knowledge and is already present on the particular market (Ibid).

Due to existing globalization and previously mentioned business conditions, for some companies gradually internationalization process is not an option. Subsequently, this model is not applicable for *born global* companies. This content refers to company that gains competitive advantage through using resources and organizing value chain in different countries and see the world as marketplace (Knight, 1996).

According to Hennart (2014), the Uppsala model can be applied only to a specific group of firms, mostly to those, which customers require adapted marketing strategies and logistical investments. Hennart claims that internationalization speed depends on the business model of the firm, meaning that internationalization pattern hinge on "*what they sell, how they sell and to whom they sell*" (Hennart, 2014, pp. 117). Firms selling niche products may internationalize rapidly because there may be no need to spend more time or resources for sales to customers abroad than to domestic customers. Moreover, Uppsala model is more appropriate when analyzing internationalization process of firms that use equity entry modes that require huge investments and are more risky. Before making investment decisions, firms need to examine a new market more carefully and this process can take more time. Such companies need more time to assess risks and opportunities in a target market. In contrast, born global firms quite often sell niche products and there may exist the shared knowledge between customers and the seller regarding the product. The shared knowledge reduces psychic distance between the country of product origin and the buyer's country, thus allowing firms to internationalize more rapidly and do not need to enter psychically close markets before moving to more distant markets (Fan and Phan, 2007) as Uppsala model suggests.

Revisited Uppsala model

Having in mind numerous limitations Uppsala model was facing with, pronounced authors of the theory decided to revise it, and consider how company can simplify internationalization process through strengthening position within an existing network. According to Johanson and Vahlne (2009), company's decision regarding entering on market and applied entry mode is predetermined with participation in the business network.

In addition, here is an assumption that company already belongs to the business network and has built interrelationship with others in that network. By using the other companies' gained knowledge within the network, company can expand area of interest and enter in markets with higher distance. This will strengthen company's position in the network and ease decision making in regard to relevant entry mode. In revised model, Johanson and Vahlne perceiving internationalization process as a set of opportunities that should be explored (2009).

This can be described as one of the main differences comparing with the previous model, where internationalization is explained as "*overcoming of uncertainties*" (Ibid).

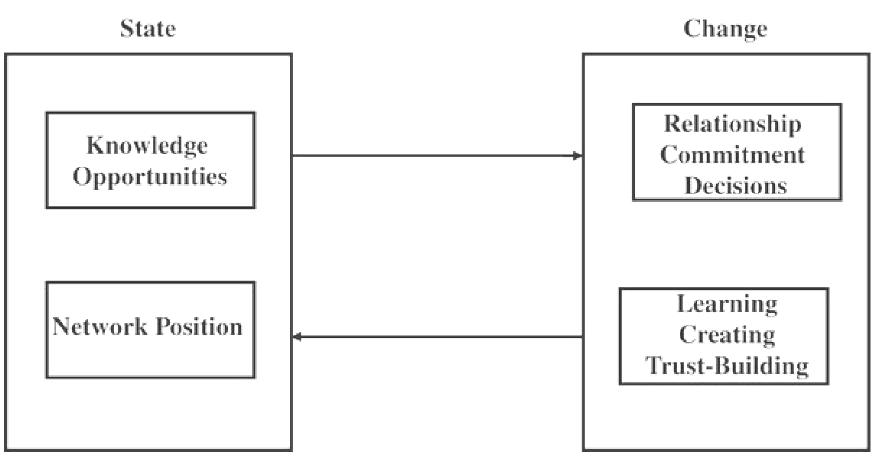

Figure 5- Revised Uppsala model (Source: Johanson and Vahlne, 2009)

Instead of previously mentioned level of knowledge as prerequisite for company's commitment on the market, here in focus are exploitation of opportunities and network position as crucial determinants of commitment level. Briefly, in revised Uppsala model Johanson and Vahlne (2009) argue that company needs to build strong level of commitment with other companies in the same network. By strengthening those commitments, company is gaining access to knowledge, which can contribute in detection of new opportunities.

In the revised Uppsala, for authors, opportunities are the most important source of knowledge. Other relevant elements of knowledge are capabilities, companies' networks and strategies (Ibid). The revised Uppsala is pointing out that internationalization process is more effective in the network, where companies can learn and build the trust.

Further development of relationships among companies in the network is resulted from development of knowledge, commitment and trust building (Ibid).

Liability of outsidership

The liability of outsidership describes difficulties related with the entrance to a new foreign market where the firm does not have any position in business-relevant networks (Johanson & Vahlne, 2009). According to revised Uppsala model, being part of the relevant network is crucial for company's internationalization process, as a company is in position to use the knowledge gained by others inside the network, and strengthen the position. This content can be defined as insidership. Opposite from the insidership, companies can be challenged with liability of outsidership, and deprived from relationships with others. This can result in lack of knowledge that might be gained from companies within the business, lack of trust and commitment and, therefore, can slow down internationalization process. Since content of outsidership is identified after revised Uppsala model, Johanson and Vahlne (2009) are arguing that relationship between companies bring the learning possibilities, build the trust and strengthen the commitments.

Overcoming liability of outsidership

Since the content "*outsidership*" is primarily related with an absence of position in any relevant business network, subsequently, there is an assumption that overcoming the liability of outsidership is determined with realizing of networks importance and becoming a part of it. Therefore, insidership is crucial for successful business and internationalization process. The position within the network brings different possibilities for learning, stronger commitment and trust building, which are, furthermore, prerequisites for internationalization process.

In addition, several ways of overcoming outsidership can be considered. The first and foremost is realizing of the necessity of existing networks. This means that a company needs to recognize the importance of its outsidership to relevant business networks and focus resources towards overcoming the gap (Coviello, 2006). Furthermore, in order to participate in a relevant business network, it must be identified first. This means that company should focus on accessible networks, and both directly and indirectly relevant for business.

Once when relevant networks are identified, company must establish a plan how to reach a particular network. Very often that can be done by the use of already known members, which are used as an “entry ticket” in developing and strengthening relations with others. At the same time, companies constantly need to improve their image and visibility and promote themselves within existing networks.

Liability of foreignness

In addition to the Uppsala model, the liability of foreignness (LOF) has been chosen by authors to explain what the reasons behind the gradual internationalization process are. This concept was introduced by Hymer (1960), who argue that entrant firms are facing challenges and disadvantages on the foreign market due to lack of familiarity with business conditions and foreign exchange risks. For entrant firm liability of foreignness is consisted from different barriers with more or less permanent nature. Hymer (1960) is referring to four main barriers, where foreign exchange and discrimination by host government are having more permanent nature.

Other barriers, such as information disadvantage, entrant firm’s management can overcome in a shorter term. Local firms possess advantage comparing with focal, in higher level of knowledge about country specific economy, market and law. This knowledge can be gained by entrant firm either through considering learning strategy, or as a consequence of doing business for a longer period of time (Ibid).

In further development of this concept, the following sources of liability of foreignness are distinguished:

- Cost related with distance, such as travelling, transportation costs and coordinating over different time zones (Zaheer, 1995).
- Higher learning costs. Those costs can appear from lack of experience and knowledge about the local environment.
- Legal restrictions costs. On a particular market, different types of restriction can exist. Host markets restrictions can cause liability of foreignness.
- Reputation-building costs. This type of costs appears as a lack of legitimacy knowledge in the host country.

Furthermore, Zaheer (2002) recognizes three main hazards in the LOF concept with strong impact on entrant firm:

- <u>Unfamiliarity</u>: as previously underlined unfamiliarity with a host country market have strong impact on creating disadvantages for entrant firm. This additional cost can be temporary for company if there is orientation and focus on actively learning about the market and environment.
- <u>Discriminatory</u>: there are many sources of discrimination, and usually it affects foreign firms in host country. Those sources are mainly consumers, home and host governments. Host country government can act discriminatory in order to protect domestic production and position of local companies in the market. Also, discrimination can be the result of lack of knowledge about the foreign company.
- <u>Relational hazards</u>: These types of costs are consequence of external and internal uncertainties in the foreign company. External uncertainties refer to lack of knowledge about host market and capability to predict the future conditions. Internal uncertainties are result of organization of business activities outside of home country.

Overcoming liability of foreignness

The strategy for mitigating the liability of foreignness varies from one company to another. Overcoming LOF is essential for company´s survival in foreign market and accumulating the profit. How strong LOF impact on the company will be depends on company´s experience and strength. Therefore, several ways of overcoming can be identified.

The first mitigation step can be importing home country organizational capabilities. This process can be very expensive and requiring a lot of time, especially when comes to adjusting those capabilities to a foreign market. Still, to be able to overcome LOF and compete with local companies, a firm needs to emphasize its advantages by transferring its managerial capabilities to the unit established on foreign market (Dunning, 1977). Firm specific advantages can arise from cost savings resulted by economies of scale or scope. The company can also use advantages such as strong brand name or innovative product (Ibid).

Another activity can be either hiring people with high level of knowledge about the market, or by copying activities from host-country companies (Zaheer, 1995). As emphasized, the degree of liability varies from company to company. The important prerequisite is level of company´s international activities or gained international experience. By default, it is easier to overcome liability for company with larger international experience. Although the focal company does not possess sufficient knowledge about the particular market, gained experience built through expansion on different markets, and adjusting to various markets' conditions and requirements can be sufficient to ensure successful penetration (Ibid).

Uppsala model and liability of foreignness

There is a significant link between previously analyzed internationalization model and the content that describes difficulties companies are facing when expanding abroad. Both are considering internationalization process. Uppsala model argues that firm should expand on foreign markets in small and incremental steps and subsequently, decrease the risk. According the developed content of liability of foreignness, every firm in internationalization process will experience additional costs, due to lack of knowledge about the particular market and time needed for gathering it. There might be potential ways to mitigate those costs via importing organizational capabilities, but that is predetermined how capabilities are suitable for host market conditions. Hence, by following the steps described in Uppsala model, firm can prevent higher costs and enter the market with the gained knowledge and subsequently decrease the liability of foreignness.

Pace of internationalization

Pace of internationalization is one of the key aspects in the analysis of firm's internationalization patterns. It is an important element of firm's international strategy, especially when deciding how to balance available resources and international opportunities (Chetty et al., 2014).

The concept of pace of internationalization is under researched (Casillas and Acedo, 2013). A relatively small number of scholars have investigated how firms should manage speed of internationalization and how to measure pace of internationalization. Moreover, the concept has not been integrated into internationalization models. There is lack of studies regarding the determinants and outcomes of pace of internationalization (Chetty et al., 2014).

In order to describe the phenomenon, internationalization business scholars refer to speed and pace of internationalization. Both terms are used as synonyms. There are two views on pace of internationalization. Some authors refer to speed as *"the time it takes to internationalize from inception of the firm"* (Chetty & Camp-bell-Hunt, 2004; Zahra, Ireland, & Hitt, 2000, cited in Chetty et al., 2014, pp. 633-634). This approach only determines the time between firms establishment and start of internationalization. Such view on speed does not take into account the subsequent period of internationalization and process of foreign expansion (Ibid).

Wagner (2004) suggests to measure pace of internationalization as *"the number of foreign subsidiaries divided by number of years since the firm's first foreign expansion, and change in foreign subsidiary sales-to-total sales ratio"* (cited in Chetty et al., 2014, pp. 634). These measurements are suitable in studies of large MNE. Another approach in measuring pace of internationalization is to determine how many markets firm is entering in a certain period of time

(Karlsen). In addition, Karlsen suggests examining which regions firm enters in terms of psychic distance and in what order.

When describing pace of internationalization scholars refer to two approaches described by two distinct theories: Uppsala model and born global concept. As described previously born global enterprises internationalize with a high speed soon after the establishment. Therefore, the core aspects in the born global studies are early internationalization and speed of foreign expansion (Chetty et al., 2014).

In contrast, the stage model describes traditional internationalization pattern where firm gradually increase the number and diversity of markets it expands to (Johansson and Vahlne, 1977). Johansson and Vahlne (1977) argue that differences in language, culture, business practices and industry development have a negative effect on the pace of internationalization. Therefore, firms tend to enter markets that are more distant in later stage of international expansion. However, it can be found that some firms internationalize more rapidly than Uppsala model suggests by skipping some stages and achieving a certain degree of internationalization within shorter period of time (Oviatt and McDougall, 2005).

According to Chetty et al., 2014, pace of internationalization can be measured also as the speed of acquiring international experience and committing internationally. Oviatt and McDougall (2005) state that the pace of internationalization is dependent not only from acquired foreign market knowledge but also from firm’s performance on domestic market. There are several other factors besides international market experience, which determine the speed of foreign expansion. Nordstrom (1991) argues that pace of internationalization can be influenced by following factors: size of firm, degree of international competition and experience of doing business. Top management decisions also have an influence on the pace and pattern of internationalization (Oviatt and McDougall, 2005). This means that the strategy of company has a certain influence on the pace of internationalization. For instance, the goal of traditional companies that adopt gradual expansion approach is to grow to reach a level, where it can take advantage from economy of scale, economy of scope, or exploit location advantages and protect business from seasonal fluctuations. These firms might have a vision to become large MNE at some point in future; however, it is not part of their international strategy. Traditional companies expand in domestic and international markets gradually. In contrast, born global companies strive to gain a leading position in emerging markets or niche (Oviatt & McDougall, 1994). They internationalize faster in order to harvest benefits by gaining competitive advantage through operations in multiple markets. Moreover, according to Barney (1991), firm may increase international activities when strategic direction is aligned with firm's capabilities and resources.

Oviatt and McDougall (1994, 2005) state that networks facilitate early internationalization of firm. Networks are important in order to identify business opportunities on international scene. Authors claim that networks have stronger influence on choice of country than psychic distance. If firm is part of the network, when discovering business opportunities, it may internationalize with unusual speed, and lack of strong ties will most likely lead to slower expansion (Ibid).

Therefore, one could suggest that pace of internationalization can be analyzed looking at following parameters: the time passed from firm's establishment to the first foreign expansion, number of new markets entered, number of new openings undertaken over certain time period. This will allow determining whether Zara has followed traditional company expansion model or it has expanded as a born global company. Furthermore, Zara's market choices will be analyzed by examining which markets the firm has entered in terms of psychic distance and in what sequence. Additionally, authors will examine how acquired international experience have affected Zara's pace of foreign expansion.

The Eclectic paradigm

Internationalization can be fostered by a combination of different internal and external factors. The Dunning eclectic paradigm has been broadly used to analyze determinants of foreign direct investments (FDI). Until 1988, the eclectic theory has been applied exclusively to international production. Over time, the theory has been extended to cover all value adding activities (Pedersen).

The main assumption of the eclectic paradigm is that FDI can be explained by three variables: ownership advantages (O), location advantages (L) and internalization advantages (I) (Dunning, 1993). Therefore, the eclectic paradigm is also known as the OLI paradigm. The eclectic framework is a good tool to understand what kind of advantages the company possess. Dunning claims that the strengths of each advantage determine the choice of entry mode.

When investing abroad MNEs have to possess **the ownership advantages** (known also as competitive or monopolistic advantages) over local firms in the host country. The ownership advantages help to compete in an international environment and should compensate costs associated with a new market entry and operating overseas (Pedersen). These costs are relevant to foreign companies and, therefore, do not face local producers (Dunning, 1988).

The ownership advantages are the tangible and intangible assets that the company possesses. The ownership advantages include unique resources and capabilities including the ability to find and choose the right location and establish the right strategic direction in order to utilize or even augment these assets (Dunning, 2001). The ownership advantages include not only natural resources, capital and technologies, but also knowledge, organizational structure, management skills, human capital, patents, brand and reputation, cultural, legal and institutional environment and other advantages that improves company's competitiveness (Dunning, 2000, Rugman, 2010). Dunning claims that some of the ownership advantages may come from the nationality of the company and that some country factors can be turned into firm's ownership advantages (Dunning, 1988, and Dunning, 2001).

The concept of the ownership advantages is similar to the concept firm-specific advantage developed by Hymer in 1976. The firm-specific advantage theory suggests maximizing profit through efficient resource allocation and utilization. In the literature can be could different types of firm-specific advantages that may stimulate firms to internationalize, for instance technology, access to resources or information, certain skills, product characteristics, cheap labor, etc. (Harveston and Davis, 2001). The firm- specific advantage is one of the factors besides others such as limited growth opportunities in the domestic market, tough competition, market growth potential and level of saturation, which motivates internationalization. The firm- specific advantages "*stemming from a superior ability in manufacturing, patented technology, organizational knowledge or talents, is assumed to be exploited in international markets at little or no addition cost*" (Hymer, 1976, cited in Harveston and Davis, 2001). This means that FDI should take place only when the additional costs associated with doing business overseas can be compensated by benefits of exploiting firm-specific advantages across boundaries Hymer (1976).

The second condition of the eclectic paradigm is related to the choice of location (Dunning, 1993). The host country has to possess **location advantages** that foster FDI. MNEs decide to go abroad only when it is in their best interests to combine ownership advantages with the location advantages that can offer the foreign country. MNEs prefer to enter countries that possess high degree of location advantages by engaging in FDI rather than exporting. The host country has to provide with at least some immobile factors or intermediate products that are specific to this country (Dunning, 1988). The location advantages can be natural resources, geographical factors, infrastructure, labor availability and costs, appropriate technology, market size, the education system, political factors, government activity like public intervention, tax system (Dunning, 1977, Rugman, 2010, and Pedersen). Rugman (2010) argues that is it difficult to make distinction between ownership and location advantages. Over the time MNE learn to exploit the location advantages of the market so they blend into the ownership advantages (Dunning, 2001a, and Rugman, 2010).

The location advantage concept presented in the eclectic paradigm is similar to the location theory of international investment. The location theory can be viewed from two different perspectives: supply oriented location standpoint and demand oriented standpoint. The supply oriented location theory stresses that the choice of location of production site depends on the factor costs for production. Therefore, the production sites are located in regions or countries where production and distribution costs are the lowest (Dunning, 1973). According to the demand oriented location theory, the determinant of the location is market conditions and competition environment. Combining both theories, Buckley (1985) has defined key location factors: raw materials, cheap labor force, transportation costs and protected and unexploited markets. These factors stimulate the emergence of MNEs.

The third factor in the eclectic paradigm is the **internalisation advantages**. The internalization advantages determine why companies prefer to engage in FDI rather than contracting out certain activities to a foreign company by entering in licensing or franchising agreements (Dunning, 1993). The internalisation should occur when it is more beneficial to transfer the ownership advantages within the company across the borders rather than selling value-adding activities to third parties. The decision in favor of FDI is influenced by several factors such as uncertainty, transaction costs and control over distribution channel. Internalization is preferred when the costs of market failure by engaging in licensing or franchising are perceived to be high. This implies that full control via wholly owned subsidiary over foreign operations is preferred to other entry modes like export, licensing or joint venture (Dunning, 1988, and Pedersen).

These assumptions go hand in hand with the transaction cost theory. The transaction cost theory postulates that when a firm can reduce costs or generate higher revenues, it should internalize foreign markets (Casson, 1982). Similar standpoint shares the internalization theory developed by Buckley and Casson (1976). Both authors claimed that due to market imperfections and notable knowledge firms internalize external markets in order to maximize profits and avoid certain costs. According to Rugman (1996), MNEs engage in FDI in order to retain firm- specific advantages. By engaging in licensing agreements, firms risk to lose its firm-specific advantages. Therefore, MNEs tend to postpone licensing until the ownership advantages have been almost used entirely and firms have started to produce a standardized product.

A number of researchers argue that internalization factor is closely related to the ownership advantages. For instance, according to Rugman (2010, pp.3), the ownership advantages cannot "*exist on their own without being owned (internalized) by the firm*". Buckley and Casson (1974) emphasized that internalization decisions are linked to the firm specific factors that determine the ability to organize and manage activities in an internal market. This means that MNE should be able to organize a bundle of internal activities to develop and exploit internal knowledge. Besides firm-specific advantages, Buckley and Casson have defined three other factors that influence internalization decisions (Buckley and Casson, 1976, pp.74): *"(1) industry specific factors relating to the nature of the product and the structure of the external market, (2) region specific factors relating to the geographical and social characteristics of the region linked by the market, (3) nation specific factors relating to the political and fiscal relations between the nations concerned"*. Therefore, it can be inferred that there is a constant interaction between the ownership advantages, location advantages and internalization advantages (Dunning, 2001a, and Cantwell and Narula, 2001).

Criticisms

The Dunning eclectic paradigm has been criticized a lot for its broad and vague structure. According to Pedersen the evidence of ownership, location and internalization advantages does not constitute sufficient conditions for engaging in FDI. Moreover, the model does not provide data regarding how many ownership advantages the firm has to possess to achieve a sufficient level required for internalization advantages in order to engage in FDI (Pedersen). Devinney et al. (2002) claim that it is difficult to get measures for the ownership location and internalization advantages and make them fit into the theoretical model.

The criticism has been directed also towards three types of advantages and their interdependency and necessity. As presented above many authors claim that the distinction between the ownership advantages and internalization advantages are unclear (Rugman, 1981). Whereas Itaki (1991) claims that the ownership advantages can be viewed as internationalization advantages that have been developed over time after penetrating and successful performance in the host market. Agarwal and Ramaswami (1992) stated that the OLI model looks at each of advantages separately and each factor influence the choice of entry mode separately and interaction between three advantages is not taken into account. In response to criticisms, the eclectic paradigm has been improved and adjusted, however the essence of the theory is retained.

Choice of entry modes from the Eclectic paradigm perspective

When firm has decided to enter a new market, it is important to determine the most appropriate entry mode for organizing firm's activities in a foreign market. The choice of the entry mode is a significant determinant of success of the firm's international operations (Root, 1987, Davidson, 1982 and Killing, 1982 cited in Hill et al., 1990).

The most common entry modes used by multinationals are exporting, licensing, joint venture and wholly owned subsidiary. Choice of the appropriate entry mode is a very important decision, because all entry modes require resource commitment and it is difficult to change entry strategy without loss of money and time (Agarwal and Ramaswami Agarwal, 1992).

Several factors that influence the choice of entry strategy can be found in literature. Dunning (1988) classifies these factors into three groups: ownership advantages of the company, location advantages of the host country and internalization advantages of transaction integration. Dunning identifies three alternative modes of serving a foreign market (see table 1). The firm can enter the market by exporting via distribution channels, engaging in FDI and opening the wholly owned subsidiary or entering in contractual agreements, e.g. licensing, franchising, technical assistance and management agreements or joint ventures.

Route of servicing	Ownership advantages	Internalizations advantages	Foreign (location) advantages
FDI	Yes	Yes	Yes
Trade (export)	Yes	Yes	No
Contractual resource transfers	Yes	No	No

Table 1- Alternative route of servicing market (Source: Dunning, 1988, pp. 28)

Each of entry modes is characterized by presence of specific advantages. Dunning (1988) suggests choosing FDI in cases when there are present all three types of advantages. In cases when location advantages are not present in the host market, export entry mode is preferred over other modes. The presence of internalization advantages in this case indicates that the firm may benefit by keeping control over the distribution channel. According to Pedersen, this can be explained only by having a sales subsidiary in the host market. In cases when only ownership advantages are present, Dunning suggests to use contractual resource transfer by engaging in some kind of bilateral agreements like licensing, franchising, etc. Pedersen in his working papers states that such choice of entry modes seems to be a blunder, especially in the case of entering in contractual agreements and transferring production or knowledge to markets that do not possess location advantages.

As a response to such imperfections in the matrix offered by Dunning, Pedersen has proposed an alternative approach. The underlying assumption of the Pedersen’s model is that the firm must possess ownership advantages before deciding to engage in foreign activities. Without ownership advantages, the firm is not strong enough to operate in a foreign country. Therefore, LI framework concentrates only on a presence of location and internalization advantages (see table 2). Pedersen with +L and +I indicates presence of location and internalization advantages and with –L and –I absence of respectively advantages.

When both location and internalization advantages are absent, the foreign market should be served from the home base by exporting. When both advantages are present, the most appropriate entry mode is FDI. When location advantages are absent but there are present some internalization advantages of keeping control, in order to have control over downstream activities as far as possible towards the consumers. It can be done by establishing sales subsidiary, that has not been considered a FDI according to model presented by Dunning in 1988, or hiring own sales representative. The last case is characterized by presence of location advantages and lack of internalization advantages. In order to exploit the host market's location advantages it is suggestible to enter the market in partnership with another party by engage in the contractual agreements, for instance franchising, licensing, joint venture etc. (Pedersen).

	-L	**+L**
-I	Simple export	Contractual agreements
+I	Sales subsidiary	Foreign direct investments

Table 2- Internationalization modes (ownership advantages assumed) (Source: Pedersen, pp. 25)

According to the normative decision theory, the choice of entry strategy has to be based on compromise between risk and profit. Therefore, it is expected that the company will choose entry mode that promises the highest risk-adjusted returns (Agarwal and Ramaswami, 1992). However, Cespedes (1988) argues that entry decisions determine the resource availability and necessity for control. Resource availability indicates managerial and financial capability to serve a foreign market, whereas control is related to the need to influence systems and decisions in the host market (Anderson and Gatignon, 1986, cited in Agarwal and Ramaswami, 1992, pp.3). By exercising control, the firm can improve competitiveness and increase returns.

The empirical study of Agarwal and Pamaswami (1992) revealed the strategies for entering a particular market could differ among different enterprises depending on their size, international experience and strategic objectives. For instance, some MNEs might use investment modes not only in high potential markets, but also in markets with relatively low potential because of their strategic objectives. However, enterprises are cautious to enter high-risk markets and might decide to do not enter such markets or serve such markets via export. The study showed that smaller companies that have limited international experience tend to enter high potential market through a joint venture, thus complementing assets with partner's resources and sharing risk of failure. Firms that possess stronger ownership advantages, like ability to create and produce differentiate products are entering market through investment modes, thus trying to protect their advantages. The wholly owned subsidiaries usually are establishing large multinational firms in markets with high growth potential. Enterprises that possess strong ownership advantages in terms of ability to develop differentiated products might choose to enter markets that are perceived to have higher contractual risk by establishing wholly owned subsidiary, if they believe that they will be able to offset the risk through offering differentiated goods (Ibid).

Motives for FDI (foreign direct investment)

Over time, the eclectic paradigm has been supplemented with motives for FDI. Dunning has identified four categories of motives: market seeking, resource seeking, efficiency seeking and strategic resource seeking (Dunning, 1993 and Dunning, 2000).

The **market seeking** or demand oriented FDI is directed "*to satisfy a particular foreign market or set foreign markets*" (Dunning, 2000, pp, 164). There are several reasons why companies decide to invest abroad. Sometimes domestic market is saturated and therefore firm's growth is limited or not bringing enough revenues. Thus, companies decide to enter new markets that are attractive in terms of market size, growth potential. Firms engage in market seeking FDI to follow customers or suppliers, adapt products to host markets tastes, needs and trends, save costs associated with serving market from a distance or even discourage competitors from capture the market (Franco et al., 2008).

By engaging in the **resource seeking** or supply oriented FDI, firms aims to obtain access to natural resources or raw materials such as minerals, agriculture products or unskilled labor (Dunning, 2000). In this case, firms are looking for resources that are not available at home market or are available at lower cost in the foreign country.

The **efficiency seeking** FDI are oriented towards taking "*advantage of differences in the availability and costs of traditional factor endowments in different countries*", or taking "*advantage of the economies of scale and scope and of differences in consumer tastes and supply capabilities*" (Dunning, 1993, p.60). This means that firms are going abroad in order to gain from differences of factor endowments, institutional and economic environment, cultures by concentrating production sites in a limited number of places. Economy of scale and economy of scope quite often are the focus of efficiency seeking firms. Therefore, MNE seeks to exploit differences in factor endowments between developed and developing countries and economy of scale and economy of scope in similar markets.

The **strategic asset seeking** FDI are oriented "*to protect or augment the existing O (ownership) specific advantages of the investing firms and/or to reduce those of their competitors*" (Dunning, 2000, pp.165). According to Dunning (1993), strategic resources are intangible resources related to technology and core competences of the firm. Knowledge, skilled employees, patents, strategic supplies for improving comparative advantage belongs to the firm's strategic assets. In order to improve competitiveness in long-term, the firm has to focus on developing strategic resources. It can be done in different ways, for instance by acquiring the assets of foreign firms.

Psychic distance

A number of international business scholars claim that geographic and psychic distance has an influence on the internationalization process of a firm. Firms face more complex environment when operating in foreign countries due to different economic, political, geographic and cultural conditions (Hosseini, 2008). Costs of overcoming distance to market affect internationalization patterns, such as the choice of entry strategy, human resource management practices, negotiation tactics, knowledge transfer practices etc. (Håkanson and Ambos, 2010). The costs of overcoming distance to market include costs of shipping goods to foreign market as well as costs related to learning about host markets (Ellis, 2007). The extent of complexity faced by firms in the foreign market is closely linked to the degree of psychic distance.

Economist W. Beckerman has introduced the concept of psychic distance in 1956. Beckerman claimed that besides geographical barriers also psychic distance barriers can affect international trade. However, in international business the concept of psychic distance has been introduced by Uppsala University scholars Johanson and Wiedersheim- Paul in 1973 (Hosseini, 2008). Both authors defined psychic distance as "*factors preventing or disturbing the flow of information between potential and actual suppliers and customers*" (Vahlne and Wiedersheim-Paul, 1973 cited in Hosseini, 2008, pp.197). While Swedish scholars view psychic distance in terms of cultural, structural (administrative and legal) and language differences, O'Grady and Lane argued that psychic distance also includes industry and competitive structure (O'Grady and Lane, 1996). Lee claims that "*psychic distance is the distance between the home market and a foreign market, resulting from the perceptions about both cultural and business differences, where business differences are said to be attributed to differences in language, education, business practices, political and legal systems, economic environment, religious, and industry structure*" (Lee, 1998, cited in Hasseini, 2008, pp. 941). Joliet and Hubner have defined psychic distance as "*the perceived distance between the home country and a foreign country, resulting from the differences in terms of cultural, business, and political differences, i.e. differences in language, political and legal systems, trade practice, industry structure, etc*." (Joliet and Hubner, 2003, pp. 5). Whereas Håkanson and Ambos (2010) view psychic distance as the "*subjectively perceived distance to a given foreign country*", thus referring to individual or collective perception of foreign countries and indicating that perception of foreign markets can differ from one person to another.

Ellis (2007, pp. 576) argued that "*the greater the psychic distance to a market, the greater the uncertainty and learning costs associated with entering that market*". Therefore, by entering psychically close markets, firms reduce the level of market uncertainty (Johanson and Vahlne, 1992). Kogut and Singh (1988) claimed that firms find it easier to learn about markets in psychically close countries. According to O'Grady and Lane (1996, pp. 310) "*psychically close countries are more similar and that similarity is easier for firms to manage than dissimilarity, thereby making it more likely that they will succeed in similar markets*". Therefore, there is an assumption that "*in psychically close countries should improve the company's chances of successes in these markets*" (O'Grady and Lane, 1996, pp. 310). However, several empirical studies have found that entering a psychically close country does not always ensure success. O'Grady and Lane (1996) claim that firms may fail entering psychically close markets due to perceived similarity and unpreparedness for dissimilarities. The authors have called this phenomenon psychic distance paradox. The phenomenon implies that individuals may be boundedly rational when assessing international environment and that decision makers have limited capacity for facing complexity of foreign market (Hosseini, 2003).

According to Johanson and Vahlne differences in language, culture, political system, level of education or industrial development have an influence on FDI, international production and other business activities, because dissimilarities affect the information flow between firm and the foreign market (Hosseini, 2008). Johanson and Vahlne (1992) in their work claimed that firms take first steps in internationalization in markets that are less distant psychically before moving to more psychically distant markets. Moreover, by the gradual integration process (beginning with export and over the time moving to joint venture or wholly owned subsidiary) firms try to reduce level of uncertainty and risk.

Institutional theory

The purpose of following chapter is to provide a clear understanding of institutions' roles in internationalization process of companies. Therefore, some basic contents such as organization, organizational behavior and institution will be discussed. Moreover, chapter is reviewing several elements of institutional theory, with goal of defining what rules and norms firms need to follow and what is role of regulative institution in internationalization process.

In the focus of institutional theory are organizations and their behavior. The organizations need to adapt to the existing structure in their operational area and organizational zone. Institutions are both, limiting and promoting factors for organizational behavior and organizations. An organization can be observed as system of wittingly coordinated activities with the task to accomplish the goal through allocation of functions and responsibilities (Selznick, 1948). Collaborative entities can be other firms, regulatory commissions, governmental departments and different associations. From this perspective, an organizational behavior can be defined as system in which organizational overview of needed resources is determined with created and developed relationships (Selznick, 1948). Institutional theory considers established guidelines for a social behavior in a form of different structures, rules, norms and routines (Scott, 2004).

Institutions have been defined as "*regulative, normative and cognitive structures and activities that provide stability and meaning for social behavior*" (Scott, 1995). According to Scott, one of the most quoted authors of the institutional theory, there are three groups of elements that create stability and provide meaning to a social life (Scott, 2004). Those are: cultural-cognitive, normative and regulative.

- Cultural-cognitive elements of institutional theory: the primary role of cultural-cognitive elements is to model acting of organizations, which are aiming to adjust to different environment in order to legitimize. Performing in a different environment might be determined by institutional value system of institution, and internal believes, norms and standards in the organization. Scott argues that cultural cognitive elements are based on the role that organizations are playing as they are defining its meaning. This means that roles are defined through communication and interaction with others. Cultural-cognitive elements of institutional theory are underlying defined actions for certain types of organizations as well as standards for actions, which are defined with existing rules and obligations (Scott, 2004).
- Normative elements of institution: normative elements consolidate values and norms, having in mind that values here are representing desired stage and norms are path to that stage. Subsequently, in normative elements, values are standards, organization is aiming to achieve, while norms are legitimate way to accomplish it. According to Scott, institutions’ normative elements are underlying values, norms and obligations, where social obligations are in the focus. Normative elements are defined as a part of process where organizations are aiming to become similar to one another, based on behaving according to established roles.
- Regulative elements of institution: those elements are mainly focused on rules and legislation. These elements have a task to regulate organizations´ acting under institution and ensure their performance and achieving of desired status is according to law (Ibid). Scott claims that regulative elements are part of conscious aspect of institutions. Rules and legislation, which are in focus, can be established as a result of interactions among organizations or determined by the state.

While examining flexible aspects of social structure, in the theory’s scope are named elements and their adjustment over time. According to Scott, institutions are forms characterized by high degree of flexibility. Moreover, Scott perceives institutions as a social structure, made of social activities, material resources and symbolic elements (Scott, 1995). According to Selznick, organizational structures are resulted from participants' characteristics and commitments and affected by external environment, as well as constraints that are part of environment (Selznick, 1957). He argues that institutionalization can be described as a complex process consisted from changes that occurred during the time. Furthermore, he distinguishes a degree of institutionalization between different organizations. According to Selznick, organizations with clearly defined scope and goal are characterized with lower degree of institutionalization, comparing to those where targets are not underlined. Institutions are long lasting pattern for collective acting, which led to creating order and stability, and have normative explanation. Owing to diverse environments, it is a crucial for business organizations to behave in accordance with system of values and norms, in order to survive. Furthermore, organizations must identify and align under the same institution.

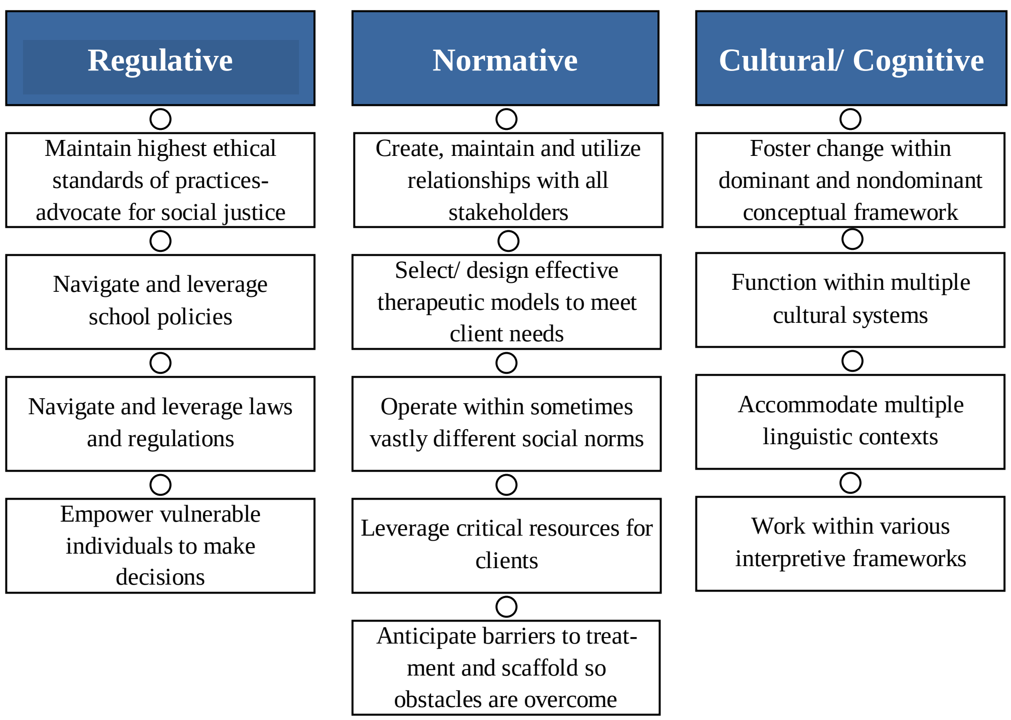

Figure 6- Institutional pillars by Scott (Source: Scott, 2004)

Institutions are dynamic and socially constructed units, and institutional theory is a framework that describes social processes. Organizations are creating their environment through the experience and interaction. Institutionalization represents ongoing social process where organizations are obliged to adopt the current vision of social reality (Scott, 1987). Developed institutionalized systems create group of elements that participate in establishing of organizational structure. Hence, organizational forms are resulted with relational networks, shared processes and existing belief systems.

The process of institutionalization can be perceived through different phases, that institutionalization is consisted of. Those phases are: externalization, objectivation and internalization (Berger and Luckmann, 1966). From an organization's perspective, externalization can be perceived as interaction with others. Others here can be other organizations or external institutions. Objectivation can be described as reviewing and interpreting organizations' action from the external perspective, where situation is separated from actors. Since objective picture of the world is internalized by organizations or actors, internalization is a process of subjective interpretation of objective events.

The importance of institutional based view in the international business literature is increasing proportionally with the cognition of institutional approach contribute in defining the organizational strategy on international level (Peng, 2004; Ricart et al. 2004).

From the internationalization perspective, the legitimacy of organizations possesses higher degree of complexity. This is primarily due to the fact that international organizations are subject to institutions' pressure in both: home and host markets.

Furthermore, Peng (2004) argues that internationalization strategy of organization is to the highest possible extent determined with institutional perspective, and therefore claims importance of the institutional based view.

The scope of institutional theory focuses on interactions between institutions and organizations. Firms' strategic choices are resulted from those interactions. According to Hoskinsson (2000), institutional theory is crucial for internationalization process.

Other internationalization theories, such as transaction cost theory (Williamson, 1991), also contains some institutional constraints and focuses on certain aspects of regulative institutions. Therefore, it can be concluded that the main difference between mentioned theories is the way, how organization structure is determined. The transaction cost theory focuses on efficiency aspects, while institutional theory- on legitimacy (Yiu and Makino, 2002).

According to Buckley et al. (2007), the significance of institutional base view is confirmed with influence regulatory policies have on firms' engagement abroad. Buckley claims that policies, regulated by home country governments can lead to company's activities on foreign markets if they are straightforward, consistent and liberal (2007). At the same time, Buckley (2007) argues that opposites, such as ambiguously regulatory policies can cause negative effects regarding outward foreign direct investments.

In addition to this, Meyer (2001) claims that unstable and flabby institutional framework causes additional costs for the host company through increased negotiation and enforcement costs, and subsequently higher transaction costs of building new business operations.

Having an organization in focus, the fundament of institutional theory is: organizations, which possess a structure similar to their institutional fields, most likely will survive and achieve the greater success due to conformity, which brings the greater political power and institutional legitimacy (DiMaggio and Powell, 1983).

According to the internationalization model, a firm, which possesses firm-specific assets, will ensure higher returns on international markets and exploiting of assets. Observed from the institutional perspective, multinational corporations can possess firm specific assets, which are determined with existing institutional environment at the home market. From the internationalization model perspective, this means that corporations which are lacking development in certain organizational aspects can enjoy advantages while competing on less developed institutional environment comparing with home market (Kirca et al., 2011).

Theoretical stand point

From the perspective of underlined problem statement, internationalization can be perceived as a process that analyzes choices made by companies and explains the organization´s boundaries. In order to provide with clear overview of the research questions in focus, we decided to gather and analyze multiple internationalization theories relevant for the emphasized topic. Moreover, discussed theories are interrelated with each other as their scope is overlapping. Hence, Uppsala model has been reviewed and the way it explains a firm´s expansion in small and incremental steps through gaining the knowledge either via lessons learned, or exploring the opportunities available by participation in the particular network. Furthermore, the main variables of the eclectic paradigm are examined in order to underline which advantages company may possess and how those advantages are affecting operational mode decision in company´s process of internationalization. Still referring to the internationalization principles, authors dived deeper in exploring interaction between institutional based view and firm´s engagement abroad trying to define the institutions´ impact on home and host markets. In addition, psychic and business differences between home and foreign markets are analyzed with the purpose to clarify how economic environment, business practices and legal systems are determining the degree of psychical distance and whether the choice of host markets and entry strategies are driven by these differences. The fundament is internationalization process; hence, by developing the literature overview authors are aiming to investigate how different aspects are influencing a firm´s choice to expand the boundaries. Subsequently, the analyzed theories are bringing a solid base for developing the conceptual framework for further analysis.

		Theories of internationalization									
		Transaction cost theory	***Liability of foreignness***	***Uppsala model***	***Liability of outsidership***	***Eclectic paradigm***	***Entry modes***	***FDI***	***Psychic distance theory***	***Institutional theory***	***Other (theories and researches)***
	Opportunism	TCT (Williamson, 1985)									
Behavioral factors	*Bounded rationality*	TCT (Simon, 1961; Williamson 1985; Martins et al.2010)									
	Behavioral uncertainty	TCT (Williamson, 1985;1993)	LOF (Zaheer, 2002)								
	Business model										(Hennart,2014)
	Market experience			UM (Johanson &Vahlne, 1977)							
	Position within the network			UM (Forsgren, 2002; Johanson & Vahlne, 2009)	LOO (Johanson & Vahlne, 2009)						
Firm specific factors	*Firm's specific advantages*	TCT (asset specificity) (Williamson, 1989; Pawlicz, 2011)				EP (Ownership advantages) (Dunning, 1988)					Firm's specific advantages (Hymer, 1976)
	Strategic objectives						EM (Hollensen, 2011; Bartett, 2009; Hitt, 2009)				
	Market knowledge		Unfamiliarity with host market, external uncertainty (Zaheer (2002)	UM (Johanson & Vahlne, 1977; Hollensen, 2007; Fan & Phan, 2007)							

Table 3- The overview of internationalization theories and main concepts (Source: Authors' creation)

		Transaction cost theory	*Liability of foreignness*	*Uppsala model*	*Liability of outsidership*	*Eclectic paradigm*	*Entry modes*	*FDI*	*Psychic distance theory*	*Institutional theory*	*Other (theories and researches)*
Host country location factors	*Available resources*					EP (location advantages) (Dunning, 2001; 1993, 1988); Rugman, 2010)					Location theory (Dunning, 1973)
	Industry and competitive structure (market saturation)					EP (location advantages) (Dunning, 1993, 1988)		FDI (Dunning, 1993; 2000; Franco et al, 2008)	Joliet and Hubner, 2003		Location theory (Dunning, 1973); Internalization theory (industry specific factors) (Buckley & Casson, 1976)
	Business conditions		LOF (Hymer, 1960)			EP (location advantages) (Dunning, 1993)					
	Psychic distance			UM (Johanson and Vahlne, 1977)					PD (Beckerman; Hosseini, 2008; Lee, 1998; Ellis, 2007)		Internalization theory (region specific factors) (Buckley and Casson, 1976)
	Institutional environment		LOF (Hymer, 1960)			EP (location advantages) (Dunning, 1993, 1988)			Joliet and Hubner, 2003	IT (Selznick, 1948; Scott, 2004; 1995; Peng, 2004)	Internalization theory (nation specific factors) (Buckley and Casson, 1976)

Table 3- The overview of internationalization theories and main concepts- continued (Source: authors' creation**)**

Conceptual framework

In the theoretical overview, several theories have been discussed with the goal to provide better understanding of internationalization patterns. As previously mentioned, reviewed theories are fundament for developing authors' conceptual framework. Hence, interconnection between chosen theories resulted with two groups of factors that determined main aspects of internationalization process relevant for the research paper. The first group is focused on characteristics that company in international expanding process might have. Furthermore, those characteristics can ease the process as they are outcome of the company's previous activities or additional values which can increase its competitiveness. Those factors are: market experience, firm's specific advantages and strategic objectives. Beside company's attitudes, reviewed theories are examining factors that host markets might possess. From this perspective, authors are recognizing psychic distance from home to host markets, market attractiveness and particular business and institutional conditions as the most relevant.

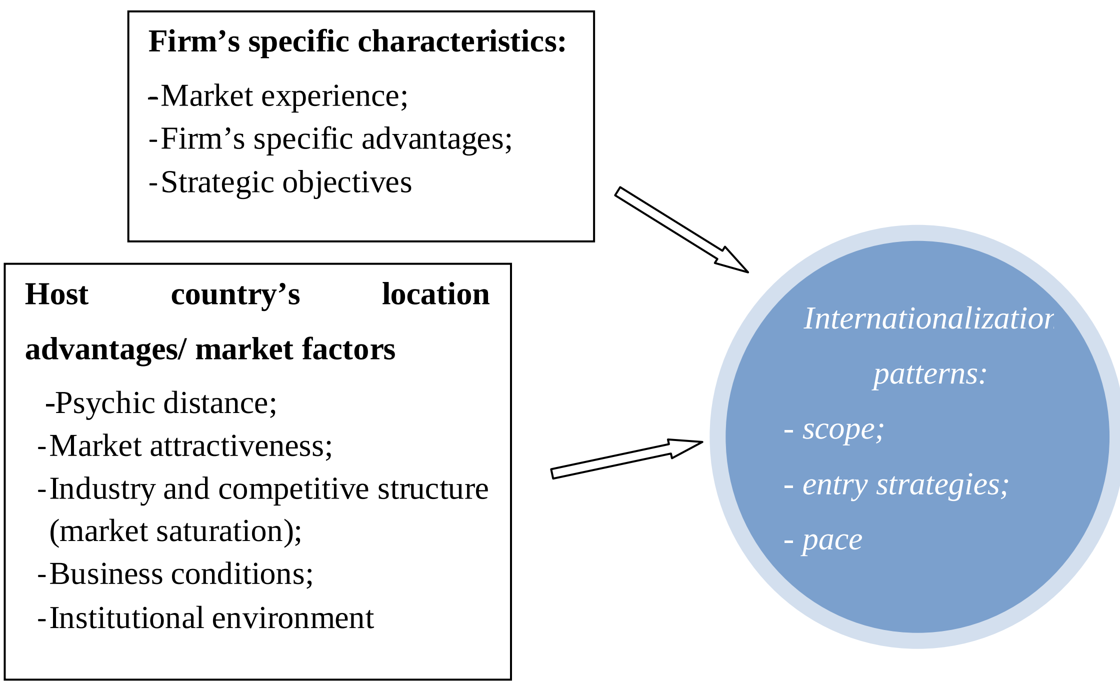

Figure 7- Authors' conceptual framework

For the purpose of further analysis in the paper entry strategies, pace and scope of internationalization are underlined as key factors describing internationalization patterns. This choice has been made due to the fact that each of discussed theories is focused on patterns that company is applying or building while expanding abroad. Therefore, it can be argued that entry strategy selection, pace and scope of internationalization is predetermined with firm's specific characteristic and host country's factors.

Thereby, previous market experience and strategic objectives are affecting the speed of company's international expansion, as firms that are penetrating into foreign markets at a high pace will not have sufficient time to evaluate the gained foreign experience. At the same time, having the scope of internationalization in focus, it can be concluded that unprepared foreign expansion which lacking clearly defined strategic objectives and information about the institutional environment can bring more challenges for company while internationalizing. Entry strategy choice is resulted not only with the advantages that company might possess, but also with the evident psychic distance and host market's business conditions. In addition, this means that company's strategy and level of commitment are appointed with the perceived risk and desired degree of control.

METHODOLOGY AND METHOD

A research can be approached and conducted in different ways. Researcher's standpoint about the reality plays an important role in the research paper. Thereof, it is essential to present methodological aspects and approaches the dissertation is built on. First of all the main aspects of methodology will be briefly clarified. Afterwards the authors' basic assumptions about the reality and selected methodological approach will be explained and justified. Furthermore, in the chapter methods undertaken during the investigation and the way of data collection will be described.

Methodological aspects

This subchapter will explain the main concepts of methodology that are relevant for the dissertation. In the beginning the concept of paradigm will be presented, it will be followed by explanation of two polar research approaches: objective approach and subjective approach.

All investigations and researches are based on the certain methodological assumptions that play a significant role in the research process. The methodological assumptions determine the way how researchers see, understand and explains the reality (things happening around them). Thomas Kuhn (1962) has used a concept "paradigm" to describe methodological assumptions and approaches that underlie the research. The first definition of paradigm comes from Kuhn's work "The Structure of Scientific Revolutions" (1962), where the philosopher of science defines paradigm as *"a cluster of beliefs, which guides researchers to decide what should be studied and how results should be interpreted" (Kuhn, 1962).* Kuhn claims that the research is built on common understandings regarding the phenomenon under investigation. Bryman has proposed following definition of paradigm: *"[A paradigm is] a cluster of beliefs and dictates which for scientists in a particular discipline influence what should be studied, how research should be done, how results should be interpreted" (Bryman, 2011, p. 24).*

Thus, it can be inferred that the methodological approach determines how the reality and individuals is to be seen, how reality is to be understood, what kind of questions should be asked, how research should be structured and how conclusions drawn (Kuada, 2012). In turn, term “paradigm” stands for beliefs that determine the way of knowledge gathering and interpretation of the research results.

The main concepts used in the research methodology

At first glance may see that Burrell and Morgan (1979) and Arbnor and Bjerke (1997) have different assumptions regarding the methodological issues that affect business research. Burrell and Morgan (1979) use following concepts to describe the path of the research: ontology, epistemology, human nature and methodology.

The term “***ontology***” is used to depict the way how individuals see the reality and act in a social construct. In research, ontology describes what researcher seeks to investigate. Burrell and Morgan argue that ontology is “*assumptions which concern the very essence of the phenomena under investigation*” (*Burrell, 1979 cited in Teale et al., p.106*). Whereas Saunders et al. (2009, pp.110) ontology defines as *“assumptions that researchers have about the way the world operates and the commitment held to particular views”.*

Epistemology is related to the nature of knowledge and knowing. Epistemology answers the question “how we know what we know?” and what we consider to be true (Kuada, 2012, pp. 59). Burrell and Morgan (1979, pp. 2-3) define epistemology as *“assumptions about the grounds of knowledge – about how one might begin to understand the world and communicate this as knowledge to fellow human beings. These assumptions entail ideas, for example, about what forms of knowledge can be obtained, and how one can sort out what is to be regarded as “true” from what is to be regarded as “false””*. In the focus of epistemology is the question whether knowledge can be obtained from other human beings or through personal experiences, or social actors that are directly involved in observed social activities.

The third set of assumptions is related to ***human nature***. The concept of human nature explains relationships between social actors and environment around them (Burrell, 1979).

Burrel and Morgan (1979, pp. 2) refers to **methodology** as “*the way in which one attempts to investigate and obtain knowledge about the social world*”. Whereas Kuada (2012) argues that methodology is a framework of the research process or a plan of action. Methodology determines how the researcher will obtain data or knowledge to conduct the study. According to Burrell (1979), different perspectives on ontology, epistemology and human nature might result in different methodologies.

While Arbnor and Bjerke (1997, pp.15) refer to following concepts that determine the way of conducting the research:

- ***conception of reality*** referring to the assumptions about the reality and the way how it is constructed;
- ***conception of science*** referring to the obtained knowledge during education and its influence on the researcher's perception of reality and believes about the objects and subjects under the investigation;
- ***scientific ideals*** referring to researchers desires he or she wants to achieve by conducting the research, and believes regarding the nature of science in terms of objectiveness and subjectiveness;
- ***ethical and aesthetical aspects*** referring to the researcher's perception regarding moral suitability or unsuitability.

By looking deeper at works of Burrell and Morgan and Arbnor and Bjerke, it can be inferred that the authors share similar viewpoints only are using different terminology. Some of the philosophical assumptions presented by the first authors overlap with one or more assumptions defined by the other (see figure below).

The main assumptions of the conception of reality presented by Arbnor and Bjerke (1997) are similar to the concept of ontology defined by Burrell and Morgan (1979). Both concepts seek to explain assumptions about the reality. Arbnor and Bjerke's (1997) conception of reality overlap also with Burrell and Morgan's concept of human nature. Both terms are used to describe relationships between reality and humans.

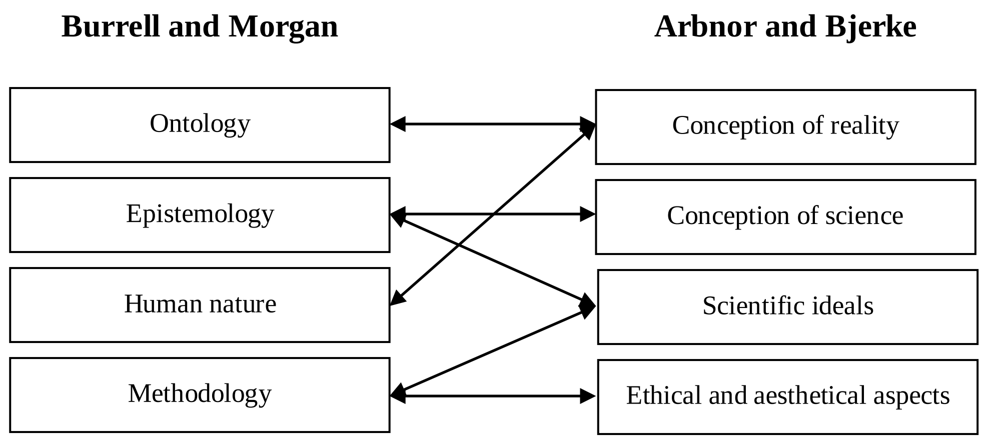

Figure 8- Comparison of the main concepts of the methodology (Source: authors' creation based on Arbnor and Bjerke (1997 and 2009) and Burrell and Morgan (1997))

Arbnor and Bjerke's conception of science covers concept of epistemology presented by Burrell and Morgan. Both concepts focus on explanation of the knowledge creation process and is looking for the answer to the question "*what can be considered as truth*".

Arbnor and Bjerke's scientific ideals are similar to the concept of epistemology and methodology defined by Burrell and Morgan. Both terms are used to explain the cognition of reality from objective or subjective point of view in terms of causal relationships or social construction. Objectivists try to discover and explain causal relationships between constituent parts with a goal to understand and predict the reality. They believe that researchers can be objective and that phenomenon can be observed from outside by external investigator. In contract, followers of subjectivism believe that the reality is socially constructed and, therefore, can be observed only from standpoint of individuals directly participating in investigated activities (Kuada, 2012 and Arbnor and Bjerke, 2009).

Ethics and aesthetics can be related to the methodology concept of Burrell and Morgan (1979), as both concepts deals with issues related to researchers' morality and openness when carrying out the research.

Based on the discussion presented above it can be inferred that following aspects influence the way of carrying out the research:

- Ontological standpoint relating to assumptions about the reality and role of human beings in it;
- Epistemological assumptions explaining how individuals know what they know and how knowledge can be obtained;
- Methodological assumptions explaining how research is approached in terms of:
    - Scientific ideals defining the goal of the research and link between theory and phenomenon under the investigation as well as method of conducting the research;
    - Ethical and aesthetical considerations focusing on morality, ethics and values of the researcher, that have an influence on the process of carrying out the research, judging acquired data and drawing conclusions.

Arbnor and Bjerke's paradigms and research approaches

Arbnor and Bjerke's classification of paradigms is one of the most recent typologies. The authors have made a distinction between the theory of science and methodology. According to the authors, the theory of science includes 'ultimate presumptions' that can be viewed from an ontological and an epistemological perspective. Therefore, the distinction between paradigms and methodological approaches has been drawn. Paradigms are seen as a relation between the methodological approaches used by a researcher and the ultimate presumption that the researcher adapts (Kuada, 2012). Whereas methodology (operative paradigm) relates to the understanding how methods are constructed in the specific study area (see figure).

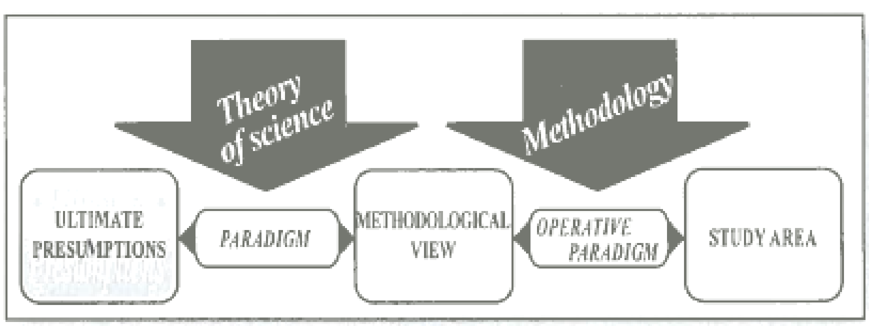

Figure 9- Theory of Science and Methodology according to Arbnor and Bjerke (Source: Arbnor and Bjerke, 2009, pp. 15)

Arbnor and Bjerke have introduced six overlapping paradigms (Arbnor and Bjerke, 1997; and Kuada, 2012):

- Reality as a concrete phenomenon that complies with law and is independent of the researcher. The reality is considered to be concrete, objective and tangible and, therefore, can be measured.
- Reality as a concrete determining process. The key assumption of this paradigm is that the society should be viewed as a developmental process where every element has an influence on the process. Therefore, the researcher has to focus on understanding the relations between parts of the society.
- Reality as mutually dependent fields of information. The society is considered as a developmental process that is based on the exchange of information. It is believed that the reality is not concrete and stable because change of one element will lead to changes in other elements of society.
- Reality as a world of symbolic discourse. The main assumption of the paradigm is that the reality is constructed based on subjective interpretations of human beings and it can be explained by humans during the interaction process.
- Reality as a social construction. The reality is considered to be more subjective than objective. It is a continuous process where social reality is build up during encounters of elements.
- Reality as a manifestation of human intentionality, where the reality is viewed as a reflection of behavior or imagination of individuals. Thus meaning consciousness of individuals is influencing and constructing the reality.

Three methodological approaches have been identified based on above mentioned paradigms (Kuada, 2012, Arbnor and Bjerke 2009): analytical approach; systems approach; actors approach.

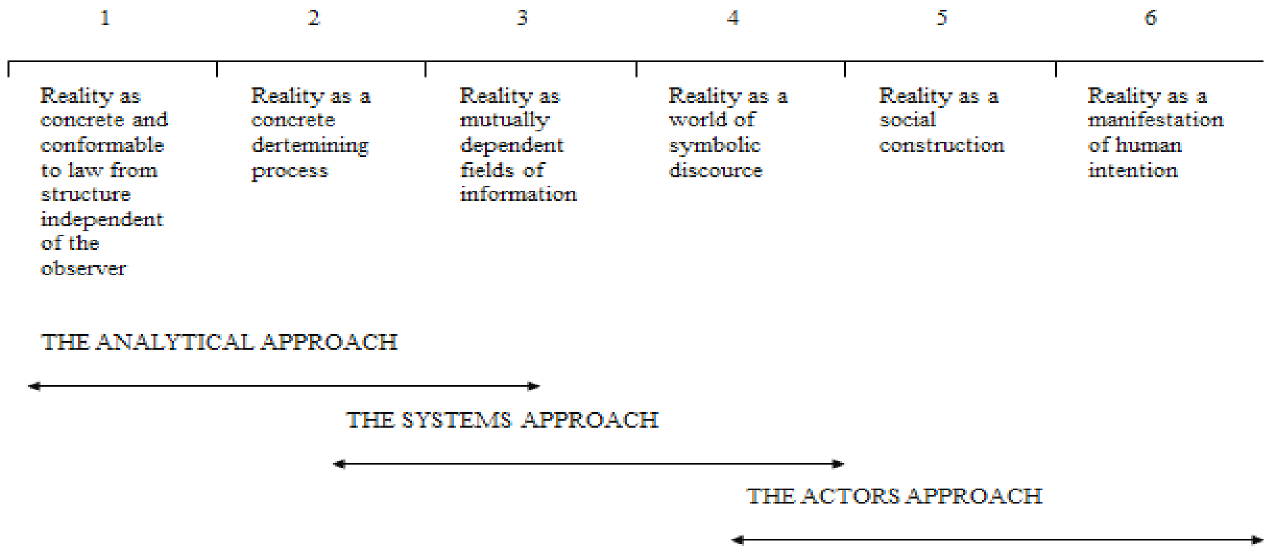

Figure 10– Methodological Approaches (Source: Arbnor and Bjerke, 2009)

Researchers adopting the **analytical approach** believe that reality is objective and independent from them. Reality consists of many parts and, therefore, it has summative nature (Kuada, 2012). Therefore, reality can be divided into components that can be investigated as separate parts of phenomenon. Afterwards, all components (new findings) can be put together to make a picture of reality more completed (Arbnor and Bjerke, 2009). According to analytical approach, reality is not influenced by surrounding and can be logically explained. The ultimate epistemological presumption underlying this methodological approach is that knowledge is grounded on facts and researchers can be neutral and distanced from people observed. Thus, knowledge is considered to be independent of individual subjective viewpoints and experiences.

The **systems approach** views *"reality as consisting of fact- filled systems structures in the objective reality and of subjective opinions of such structures"* (Arbnor and Bjerke, 2009, p. 39). In other words, a social entity (for example organization or community) is perceived as a system that consists of interconnected elements. Phenomenon cannot be observed as a separate part of reality because researchers have to find out how changes in one element will affect other elements in the system (Kuada, 2012). When applying the systems approach, observers have to see reality as objective or objectively accessible that it can be stable and also unpredictable.

According to the **actors approach** reality is subjective and it is rising from interplay between experiences of individuals and experiences of others surrounding them. The world is dependent on human beings who participate in construction of reality by creating knowledge (Arbnor and

Bjerke, 2009). So reality is constructed during the negotiation and meaning sharing process. The actors view focuses on subjectivity, individuality and interaction (Kuada, 2012).

The choice of methodological approach for the research paper

It is important to select an appropriate methodological approach in order to conduct the research successfully, because different research approaches might lead to different studies and conclusions. Therefore, when selecting methodological approach the researcher has to keep in mind the purpose of the study (the problem formulation in our case). The goal of this dissertation is to analyze internationalization patterns of Zara and find out how conditions in the host market and the company's factors have affected Zara's choice of host markets and entry modes, as well as pace of expansion.

The authors have chosen to conduct the research according to the systems approach. One can argue that the world consists of interconnected components and, therefore, can be seen as a system. Moreover, no enterprises can exist in isolation from external environment. It is a part of the bigger system- world. The systems approach seeks to understand and explain relationships between different elements by adopting objective perspective.

According to literature review, it can be inferred that there are one or more strategic motives that determine the choice of host market. In the internationalization literature, it can be found that different factors might drive the choice of entry strategies companies adopt when expanding abroad. Authors believe that expansion decisions of Zara are based on careful market analysis and assume that different host market factors might lead to choice of different entry strategies. Therefore, in the dissertation the conditions in different markets will be analyzed in order to understand how host market factors have influenced Zara's entry strategy decisions. The goal of the dissertation is to find out the motives that have guided Zara to choose to enter a particular market, as well as relationships between market factors and internationalization strategies Zara has adopted in particular markets. In additional, the pace of Zara's foreign expansion will be examined and the main factors influencing the speed of foreign expansion analyzed. Thus, it can be concluded that the goal of the research corresponds to the systems approach that states that the right combination of different circumstances will provide the solutions (Arbnor and Bjerke, 2009).

When analyzing the available data and in drawing out conclusions, authors will try to be objective. However, authors are aware that their knowledge, experience and values might have an impact on data collection, interpretation of available information and drawing conclusions. This means that it is not possible to be completely objective, when carrying out the research. This also corresponds to the systems approach that accepts that humans might have subjective opinions about the reality.

Case study research method

In the following chapter different types of case study research method and process of analysis will be defined. As the dissertation is built on single case study of the company, understanding the several types of data, the ways of collecting data as well as various research techniques is crucial.

There are several ways of doing social science research. The choice of a method is determined by different conditions, such as: the level of control an investigator has over the situation; type of research question/s and the phenomena in focus (Yin, 2009).

Case study research method is the most convenient method in situation when research questions are aiming to explain why and how an event occurred, when the control level researcher has is low. In addition, this method is suitable when contemporary phenomenon within real-life context is in focus, when the boundaries between phenomenon and context are not clearly defined (Yin, 2009). Furthermore, using case study research is resulted from a need to understand complex social phenomena in focus which is enabled with investigators possibility to keep significant elements of the real-life situation. The fundament of the case study is an analysis of decision or group of decisions, with the goal to understand: why they were taken; what was the output and how those decisions have been implemented (Schramm 1971 cited in Yin, 2009). The case study research is based on multiple sources of evidence, and relies on both: qualitative and quantitative methods.

The research path in the case study method begins with a detailed literature review, and subsequently defining unambiguous research questions, or objects to be achieved. A clear procedure of doing research needs to be established.

Strategy	Form of research question	Requires control over behavioural events?	Focuses on contemporary events?
Experiment	How, why	Yes	Yes
Survey	Who, what, where, how many, how much	No	Yes
Archival analysis	How, why	No	Yes/No
History	How, why	No	No
Case study	How, why	No	Yes

Figure 11- Relevant situations for different research methods (Source: Yin, 2009)

Owing to the fact that "how and why" questions are connected with operational links that requires following up over time, those questions are having more explanatory attributes, and, therefore, are preferred by case studies.

As mentioned, case study is characterized with investigator's low level control over the situations. This means that an investigator cannot manipulate data as a research is relying on multiple sources of evidence.

Collecting case study data

In total, there are six sources where data can be collected from, for the purpose of doing case study research: direct and participant observation, physical artifacts, archival records, documentation and interviews (Yin, 2003). The reliable and consistent case study research is built on as many as possible different, compatible and consistent evidences.

Direct observation- there are distinguished two types of activities: formal and casual. Formal observation is related with nature of behavior and mainly is used in formal occasions, such as business meetings and workshops. For the purpose of gathering data through non-formal observing, casual observation as technique can be used. An example of casual observation is field work.

Documentation- owing to certain advantages in collecting process, the most used source of data in the case study research is documentation. This is primarily because documents contain references and details; can be used many times and can be helpful in identifying new questions about the topic to be discussed.

Archival records- besides documents, archival records are used in a research paper as relevant source of data. Archival records include organizational records, statistical data, and public use files (Yin, 2009).

There are numerous advantages in using the multiple source of evidence, as they allow researcher's wider investigation. Investigators must create an appropriate case study database, with the documents and materials relevant for investigating process, in order to increase reliability of the case study. In order to provide with understanding of data and reports used in research, investigator needs to conduct chain of evidence[5]. This will ensure unambiguous genesis of research in each phase of the case study (Yin, 2003).

Source of evidence	***Strengths***	***Weaknesses***
Documentation	-can be reviewed repeatedly -contains exact names, references, and details -broad coverage	-can be difficult to find -biased selectivity -access can be limited
Archival records	-same strengths as documentation -usually very precise	-same weaknesses as documentation -accessibility
Interviews	-focus directly on case study topic	-bias as a result of bad articulated questions -interviewee gives want he/she wants to hear
Direct observations	-reality contextual	-cost -time-consuming -selectivity
Participant observation	-insightful into interpersonal behavior	-bias due to participant-observer's manipulation of events
Physical artifacts	-insightful	-selectivity -availability

Table 4- Six sources of evidence: Strengths and weaknesses (Source: Yin, 2009)

[5] Chain of evidence is process conducted by investigator with purpose to increase reliability of information in the case study (Yin, 2009)

Primary and secondary data

For the purpose of conducting the trustworthy research, several types of data can be collected. The main segmentation is on primary and secondary data. Primary data are intentionally collected for the particular research work through applying the procedures that suit research problem the most. In other words, primary data are original data, collected for a specific research goal. Subsequently, data or paper made by researchers, available for other research groups represent the secondary data. The usual primary data collection techniques are experiment, survey, structured diary (Mills et al., 2010).

Secondary data collection is based on gathering data previously collected by other researchers, mainly for the purpose different than the research work in scope. The widely used secondary data are administrative records, official statistics (annual reports) (Mills et al., 2010).

Analyzing case study data

After identifying the problem for case study research, establishing research design and collecting data from reliable sources, the next phase is analysis. The analyzing process in case study method has been defined as complex process which contains broad approaches. In order to avoid the difficulties in a case study method, initial step is choice of adequate analytic strategy which predetermines appropriate analytic technique. In case study research, there are several analytical strategies (Yin, 2003)

- Relying on theoretical propositions: the theoretical propositions need to be followed, as they are driving the case study. The main assumption is that theoretical propositions are defining plan for gathering data, and subsequently relevant analytical strategies are prioritized.
- Developing a case description: developed descriptive framework is supporting in organizing the case study.
- Using qualitative and quantitative data: as previously emphasized, case study is relying on both: qualitative and quantitative data. The examples of used quantitative data are various statistical analyses.

- Examining rival explanations: it contains all previously mentioned analytical strategies and rival hypotheses based on contrasting perspectives.

Among existing, explanation building technique is stipulated as analytic techniques useful in the case study. This technique is based on building of an explanation about the particular case (Yin, 2009).

Types of case study research

There are three different phases of case studies that research method can be used for: exploratory, descriptive and explanatory.

Exploratory case study research is focused on investigating the situation that not possesses planned preliminary research or any other factor that affects the choice of methodology. In this type of research, investigators have more flexibility as there are no limitations regarding data collection or research design. Owing to the mentioned attributes, exploratory case study is mostly used as first step in building explanatory research design, where research questions or required data are not clearly identified (Mills et al., 2010). For the exploratory case study is common to start with perceiving the object of investigation as a holistic entity and subsequently consider its attributes. Therefore, this type usually starts with collecting data about the object, where distinguishing relevant from non-relevant data is postponed until clear picture about the object in focus is provided.

Descriptive case study research, opposite from the previously defined research is briefly planned and detailed. This type of research allows to any object in focus or raised question to be investigated based on already developed theories. Furthermore, it also allows combination of existing theories in order to examine different aspects of the issue or object. The research questions about the situation in focus are defined thoroughly and serve as step stone in further development of the research paper. Descriptive case study is highly structured approach, where descriptive theory about the phenomenon in focus determines boundaries of the case.

The purpose of the descriptive case study is to approach the details from descriptive theory in depth, and based on that define propositions and research questions (Mills et al., 2010).

Explanatory case study research is aiming to understand why something occurred. Therefore, this approach provides with the realistic picture about the object within its context, and at the same time helps with overview from historical perspective. Explanatory case study research is relying on qualitative and quantitative research methods, aiming to understand not only the phenomenon in focus, but also causal relationships. The purpose of explanatory research is not to explore but to explain the situation in focus. Subsequently, this type of research is consisted from gathered relevant facts about the phenomena, having in mind alternative approaches and explanations.

The outcome is unambiguously explanation aligned with previously collected facts (Mills et al., 2010). There are three main types of explanation in research papers:

- Explanation by earlier events: data from longer period of time are required; time point in which phenomenon or situation occur are relevant and, therefore, observing the factors that might affect it is necessary.
- Contextual explanation: the goal is to find an explanation of the situation in focus, very often by using existing theories as basis for working hypothesis; those hypothesis need to be evaluated and elaborated in realistic context; phenomenon needs to be observed and examined within the context.
- Explanation by later events: different types of data can be gathered from humans in different types of interaction; the main issue is lack of consistency between gathered data and human’s action afterwards which can affect investigation of the phenomenon in focus.

Qualitative and quantitative research methods

In *qualitative* research method, the main focus is on understanding the participants´ perception about the problem in scope. Furthermore, it is activity placed in the real life context, where qualitative researchers are observing a situation in its natural environment trying to perceive different influences environment might have on the phenomenon in scope (Denzin & Lincoln, 2005). Qualitative research is defined as structural and detailed exploration and explanation process, where information and evidences about the phenomenon in focus are collected through case study or other relevant research techniques. There are several phases in research design in qualitative research: theoretical overview, introduction to a study (with research questions included), data collection and analysis, report writing and verification (Creswell, 2003).

Instead of focusing on perception, *quantitative* methods are underlying objectivity and prediction. The main drivers of these methods are tests and surveys. Quantitative methods are characterized with the assumption that "*there is a truth, existing independently from human perception*" (Lincoln & Guba, 1985). Quantitative research design is structuring the research, aiming to realize how different parts of research project are interconnected in addressing the main research question.

Choice of research and data collection methods for the research paper

This dissertation is based on a single case study describing Zara's organization and its internationalization patterns in different regions of the world. The central questions of the case study method are "how and why". This dissertation seeks to find answers to those questions by explaining the choice of markets (why Zara entered particular markets), entry strategies adopted (how Zara entered markets) and motives behind entry mode selection decisions (why Zara applied certain entry mode in particular markets). Additionally, the how and why questions will be answered by analyzing pace of Zara's foreign expansion and identifying drivers for the speed of internationalization.

The explanatory case study has been chosen for the dissertation. As mentioned above, the focus of the research is to explain internationalization patterns of Zara and find causal relationships between different factors and Zara's choices.

The case study method is characterized with a low control level of researcher over the phenomenon under investigation. When carrying out the research authors will follow objective epistemological standpoint. Therefore, it is believed that it is not mandatory to collect primary data, instead secondary data can be used. The authors are aware that collection of first hand data would be useful in order to understand better Zara's internationalization decisions. However, since the authors do not have an access to primary data, the research will be conducted based on secondary data.

In order to carry out the research, different documents, organizational records, publications, articles and research papers previously published will be used. The authors are aware that the secondary nature of the data limits the validity of the study. Therefore, in order to minimize the research bias, data triangulation will be applied by using various sources of secondary data, thus verifying the credibility of data. The research techniques described above mean that the authors will act as external researchers, therefore, having no influence on the phenomenon under investigation.

In summarizing, it can be said that the focus of this research paper is to analyze Zara's internationalization patterns by trying to explain influences of different factors on expansion decisions. This indicates that the research will have a qualitative character.

ANALYSIS

The chapter will start with a presentation of Zara's historical evolution and description of the case company's business model. The brief description of Zara will help to understand better the company in focus and, therefore, its internationalization patterns. Afterwards, the analysis of Zara's internationalization patterns will be carried out by focusing on customer side (expansion of retailing activities), where the most of internationalization is done. Zara's internationalization patterns will be analyzed on a region level by distinguishing between three main regions: (1) Europe, (2) Americas and (3) Asian and rest of the world (ROW). For in depth analysis the countries with the largest number of stores will be chosen. The host market factors on a country level will be analyzed in order to reveal the factors influencing the choice of market. Additionally, an influence of the firm's specific characteristics will be examined. Furthermore, factors affecting Zara's entry mode choices will be examined. Afterwards, the analysis of Zara's pace of internationalization will be carried out. The chapter will be closed with comparison between Zara and its main competitors in order to underline Zara's specific advantages having an influence on its internationalization patterns.

Brief description of the case company Zara

Zara's historical overview

Zara, the world famous clothing and accessories retailer, has been established in 1975 by Inditex, the textile industry company which originally was born in 1963, with the primary activity as dressmaker. In total, Inditex owns seven brands: Massimo Dutti, Uterqüe, Pull & Bear, Bershka, Stradivarius, Oysho and Zara (includes Zara Home), which is the biggest and most global brand. The prestigious venture Zara opened its first store in center of La Coruna, Spain in 1975, twelve years after Inditex foundation, by Inditex's owner Amancio Ortega Gaona (Inditex history).

From the establishing, Zara's fashion concept was accepted very well, which led company to the future expansion. In the period from 1976-1983 Zara opened nine stores in the Spanish biggest cities. This period was marked with Zara's opening of GOA and Samlor, company's very first garment factories. In years after, GOA became first Zara's head office. As the company's activities were growing, the supporting functions increased and additional facilities were needed. This brought to opening the first logistics unit, also in Spain. In December 1988, thirteen years after founding, Zara entered foreign market and opened the first store in Portugal. This period was significant for Zara, as the company continued with market expansion and one year after opening its first store abroad, penetrated in one of the biggest markets-US, through opening the store in world fashion center, New York. Two years after first international adventure, company established unit in the Paris, France. The following years brought more activities abroad, as Zara and subsequently Inditex continued with expansion into South America market (Mexico), Greece, Belgium, Sweden, Malta (Inditex history). The great sales success achieved by Zara and subsequently Inditex is to some extent a result of large number of employees engaged in sales. From total number, more than 80% of employees are responsible for sales, and minority about 20% in manufacturing and design (Person*)*.

Besides establishing logistics centers, due to increased sales abroad, in 2002, Zara opened its first distribution center in Zaragoza, Spain. This period was marked with company's decision to follow the trends and expand availability of items through online sales. In addition, the company's strategy was focused not only on market expansion, but also on expanding of assortment, through launching new products and brand. This resulted from entering the home furniture market in 2003 and launching the new brand- Zara Home. In 2007, Zara opened its 1000 store, in Florence, Italy. This year represented a certain jubilee for company, characterized with fast pace of internationalization. The company was opening stores in different countries within a short period of time. Already in 1998 Zara opened its store in Tokyo, Japan and entered Asian market. Several years after, zara.com started with online sale, reaching 16 different European markets with its online platform by the end of 2010. The following period for the company was characterized with online sales expansion (Annual Report 2011 and Annual Report 2012).

As all main markets have been reached by opening the "real" stores, in the years after accent was on increasing online sales. Therefore, with 2011 Zara goes online in the US and Asia. Nowadays, the company is reaching tremendous success with presence in around 73 countries, with more than 1500 opened stores. The biggest Zara's competitors on the international scene are: H&M, Gap and Benetton (About Zara).

In spite the tremendous success company achieved, in Zara's growing path two incidences were highlighted. The first one occurred in 2012 with pronouncing Zara as the biggest toxic threads, due to harmful toxic materials that clothes are made of. This raised awareness among buyers and companies, and led to protests, demanding Zara to stop usage of the noxiously materials, and focus on toxic-free production. In a short period, due to the public pressure, Zara decided to accept the demands and influence others to apply the same concept (Greenpeace: Toxic threads, 2012).

The second biggest incident was regarding poor labor conditions in the suppliers' companies in Brazil and other low cost countries. Zara was accused to cooperate with suppliers that use illegal as cheap labor force. From the moment it was announced, Zara warned all outsourcing companies and suppliers to regularize the conditions and treatment for its employees (Antunes, 2011).

Business model of Zara

Zara is a Spanish clothing and accessories retailer. It is one of the largest international fashion retailers belonging to Inditex group. The philosophy of the fashion group can be characterized with "*creativity and quality design together with a rapid response to market demands*" (Pahl and Mohrin, 2008, pp. 4).

Zara is the flagship retail store[6] of the Inditex group. Approximately 95% of Zara stores are company managed the rest are franchises (Annual report 2013).

Zara's has achieved a competitive advantage due to its unique business model that includes highly responsive supply chain. Zara follows fashion trends through fashion shows, magazines, movies and city streets. Zara uses trend trackers and forecasting companies (a press officer of

[6] The flagship store is a showcase for the brand established with a purpose not to generate a profit, but draw attention to the brand, broadcasting its brand status and marking itself out against its competitors (http://www.shopworks.co.uk/file/5687ff20d857d678a27ced153ef628a9/flagship-stores-a-strategic-approach-to-brand-management.html)

Inditex Group cited in Tungate, 2005, 52). Trend spotters travel all over the world or surf the Internet in order to search for new trends and ideas. Moreover, data about customer needs and preferences are collected in stores. Customer feedback is instantly sent via well-developed IT system to creative team. Zara's designers receive feedback on decisions made by customers from every store. The customer feedback inspires Zara's designer team of approximately 200 specialists.

At the heart of Zara's business model are customers. Zara is striving to meet customer needs by capturing customer feedback from every store and translating it into new fashion items. Zara tries to "*share responsible passion for fashion across a broad spectrum of people, cultures and ages*" (Zara).

The key of success is the speed at which the retailer develops and gets new products in to stores. For Zara it takes approximately two weeks. In comparison, other retailers need six month to design and produce new collections (The World's Most Valuable Brands). Zara can achieve so short lead-time because it closely controls manufacturing and produces 50% of its clothes in-house in factories located in Europe (Roux, 2002). Rest of production of Inditex Group is outsourced to workshops located in Portugal, Morocco, Turkey, China, Bangladesh, Vietnam and Brazil. The most fashionable items are made closest to headquarter, in order to achieve greater flexibility and get items in to store within few weeks (Hansen, 2012). Short lead times facilitate more accurate forecasting and prevents from inventory obsolescence and lowering of sales price (Tokatli, 2008). Such business model allows manufacturing 85% of goods during the season when they are sold (Mazaura et al., 2003).

Each year Zara is producing 11,000 fashion items in five- six colors and five- seven sizes, thus creating 12- 16 collections a year. Zara is ahead of other fast fashion retailers such as H&M and Gap that introduce around 2,000- 4,000 new items a year (Tokatli, 2008).

Thanks to short lead times, Zara delivers new items to its stores twice a week (Ferdows et al., 2004). Orders from stores all over the world are placed twice a week and shelves of stores are replenished two times per week. Zara is a pioneer in introducing so frequent replenishment model. This allows Zara to outperform competitors by 12 times faster shipments (Tokatli, 2008). Zara's centralized distribution center allows to ensure quick lead times and frequent deliveries.

In the distribution centers, all products are carefully inspected and shipped to stores. The deliveries are ensured within 12 hours after the order placement for stores located in Europe and 48 hours for American and Asian shops (Tokatli, 2008). Before shipping all items are pre-priced and tagged, most are even shipped hanged on racks. Therefore, there is no need to iron them in stores; items can immediately be put on display (Ferdows et al., 2004).

Due to frequent deliveries, Zara is sending half- empty trucks across Europe and using expensive airfreight services to get goods delivered quickly. This model is not efficient; however, Zara maintains a competitive advantage being globally responsive. Thanks to the strict rhythm and frequent replenishment, Zara’s stores look fresh and original. The retailer is known for changing collection twice a month, thus building customer loyalty (Person). Moreover, this attracts customers and stimulates them to attend Zara’s store more frequently than its competitors’ shops (Tokatli, 2008). Customers visit Zara’s stores 17 times a year, in comparison other high- street stores expect customer visits only three times a year (Person; Roux, 2002). If style is not selling good within one week it is removed from stores, orders are cancelled and new design clothes created. On average,, one model stays in the shop only for four weeks (Roux, 2002). Such business concept creates sense of urgency and stimulates customers make a purchase immediately. This facilitates sale of fashion items at full price and reduces inventory level (Tokatli, 2008).

Zara has adopted market- based pricing strategy. The target prices are set according to customers’ willingness to spend for a certain good. Afterwards, costs of materials and production are adjusted to the target price and desired profit margin (Mazaira, et al., 2003).

The retailer has succeeded without any advertising techniques. Zara has relied on stores as advertising places “*with their stylish window set ups, good music and smart lighting (…). The clothes are inexpensive and the look is a high fashion runway all in itself. It’s true when Armancio Ortega says, “less is more.”*” (Person). Instead of spending money on marketing, the company invests in real estate- in beauty, historical appeal and location of its stores (Hansen, 2012) Also, when expanding abroad, Zara is trying to keep the same style of stores. Thus, a customer entering a Zara shop located in other country will find itself in the same environment- white, modern and spacious store walled with mirrors. The latest models always can be found hanging on racks around the store (Person).

It can be impeded that Zara has maintained competitive advantage due to well- considered business model. Tightly integrated and coordinated supply chain and unique distribution channel are keys for success (Holweg, 2005). This sets challenges for Zara's competitors, because it is hard to imitate such a business model and implement rapid replenishing concept in stores across the globe. However, some business experts consider such business model as very vulnerable. Some claim that in future continuing expansion it will be very challenging to keep the control over the production quality and efficiency (Hansen, 2012).

Analysis of Zara's internationalization patterns

European markets' review

In this chapter, the significance of the European markets will be outlined and the main Zara's markets in the region identified. Since enlargement of European Union (EU) have resulted to alignment of legislation across European countries, the common issues companies face when entering any of EU country will be briefly described. Afterwards, Zara's penetration in the domestic market will be analyzed since it gives a foundation for further expansion overseas. Subsequently factors influencing internationalization choices in some key markets will be outlined.

For Spanish fashion brand Zara, European markets are very significant. Furthermore, for many years this region was considered as the home market presenting the solid base for the future growth. In addition, European markets derive the biggest sales share among all Inditex, and subsequently Zara's markets. The significance of the region can be shown with numbers, whereas European markets (including Spanish market) are bringing more than 45% of store and online sales (Annual Report, 2014).

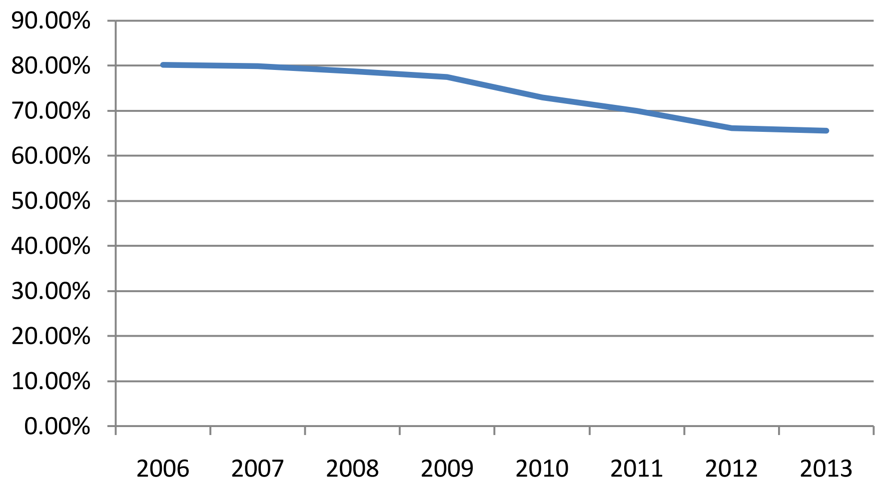

Figure 12- Inditex sales share in Europe (Source: authors' creation based on ARs)

As key European markets (besides Spain) the following are considered: France (127 open stores); Italy (94); Germany (79); the UK (66); Portugal (63). The criterions for the choice made were number of stores and level of country development which brings to the conclusion that mentioned markets are absorbing the greatest part of international growth.

The level of country development is important for the company. This primarily related with the fact that prior to the market selection Zara´s headquarter is sending a team to accomplish macro and micro analysis of the potential market and define future growth opportunities (Ghemawatt & Nueno, 2006).

The fashion industry, and subsequently textile and clothing companies are developed sector which employs more than 2 million workers. Such developed industry is a subject of many regulations provided by European Commission as main regulative body. Many European countries, including Spain, are trading in accordance with the EU´s Common Commercial Policy, which is focused on covering all relevant measures and aspects in regard to trade of goods and services. Trade policy established by EU is promoting the trade liberalization, aiming to reduce restrictions and barriers within the EU. In the same sense, EU is focused on developing measures, which can ease for its members dealing with unfair trade practices (Karabegovic and Ujevic).

In addition, this policy is covering the main issues that might occur in trade, such as: company law, indirect taxation, standards and technical regulations, intellectual property rights (Trade Regulations of the EU).

As Europe being home for many fashion design houses, emphasize is on the intellectual property protection. However, since Europe is considered as center of *haute couture*[7], Europe´s copyright regime is focused on clothes designs. There are two laws dealing with intellectual property protection: community design laws and national copyright laws (Keymeulen & Nash). The first one provides unitary right covering the EU. It is focused on the protection of registered community designs up to 25 years. The second one covers registered and unregistered designs on the national level. It is suitable for smaller manufacturers (EU Council Regulation (EC) No. 6/2002). Some of the most developed fashion markets in Europe (France and Italy) have developed strong restrictions in regard with copyright protection.

Zara's home market- Spain

Spain is the fourth largest European producer of textile. The main manufacturers and fashion retailers on Spanish market are: Zara (market share 9.8%), H&M (3.2%) and Mango (2.6%) (The dedicated followers of fast fashion, 2014). Moreover, Spain is part of the EU and as fully member follows determined forms, established by European Commission regarding regulation of community design. However, good design has been incorporated in Spanish fashion industry, which brought Spain in position of enjoying prestige and recognized design all over the globe.

As previously mentioned, Spain is home market to one of the largest fashion retailers, Zara. In spite the enormous success Zara experienced on international market, Spanish market is still very significant in terms of both: manufacturing and sales (since 50% of items are produced on home market; sales share in 2013 was 20%). Furthermore, owing to strong vertically integrated business model, some of the supporting functions are coordinated from Spain. Zara possesses centralized distribution system, which helps achieving competitive advantage through minimized distribution time of items (Annual Report, 2013). This system is consisted from central unit located in Spain and several smaller centers which support deliveries from Spain. In addition, on

[7] Haute couture refers to expensive clothes of original design and high quality

the home market company has four logistics unit which serves for gathering items produced internally and outsourced. Within the same units items are inspected and distributed to different countries' stores.

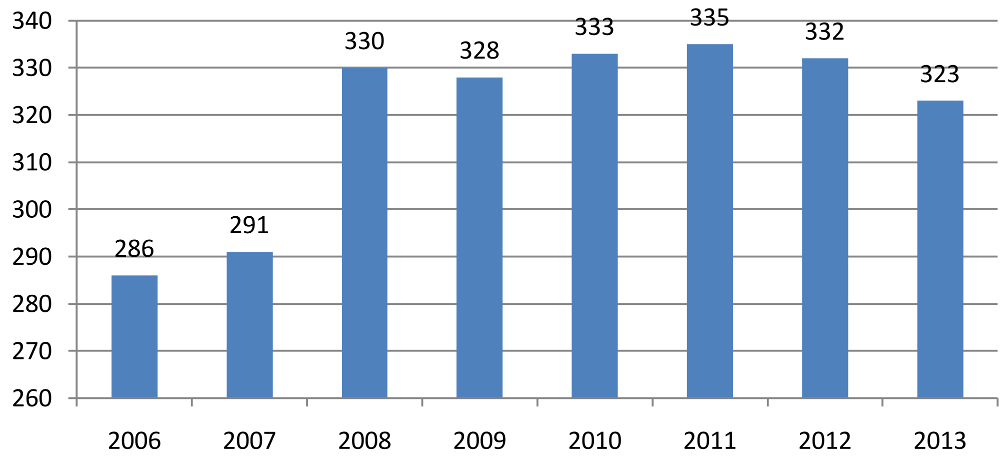

Figure 13- Overview of Zara's stores in Spain (Source: authors' creation based on ARs)

In 2003 Zara has 35% of total opened stores located in Spain. Several years after, the percentage decreased to 31%, owing to extensive presence at the international scene. All Zara's stores in Spain are 100% ownership of Inditex Group (Annual Report, 2009).

Portugal

After the expansion and afterwards saturation on Spanish market, the company started with international penetration. Zara´s international adventure started 13 years after company´s establishing; by applying gradual internationalization pattern, in a very slow pace focusing on market with lower psychical distance. There are several reasons for Zara´s internationalization decision. One of them is joining the EU which happened in 1986. This ensured the globalization of Spanish economy and potential economies of scale. The first Zara's international decision was *Portugal*, market close to the country of origin, with similar cultural characteristics and customer preferences. Following the principles of gradual internationalization, company focused on gathering needed knowledge and market experience for the future commitments.

The decision for penetrating in Portugal was resulted with the fact that for many years, younger population and Zara´s main target customer group was crossing the border and coming to Spain to buy the favorite products. This means that demand already existed, and opening the store led to meeting the customers' needs on the host market (ZARA- Spanish Fashion Shops).

The fact that production activities are also established in Portugal increases the importance of this market for Zara. According to the annual report (2000), 80% of the apparel is manufactured in Spain and Portugal, placing those markets as the high volume markets, in sense of value and number of garments. However, this situation slightly changed due to increased production in Asia (around 35%), hence in 2006 57% of Zara's production was placed in Europe. In 2007, additionally decreased, European production was almost 50% (The internationalization of Retailing, 2008).

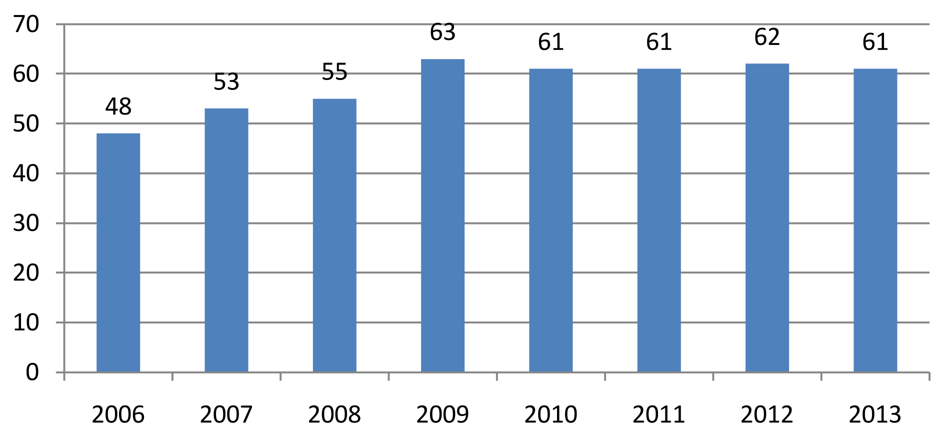

Figure 14- Overview of Zara's stores in Portugal (Source: authors' creation based on ARs)

The reason for establishing the manufacture in Portugal in such volume came with the fact that Portugal has an ambition to succeed Italy by offering a high quality production, and get the prestigious status "Made in Portugal" perceived as synonym for quality by individuals and organizations. Furthermore, the lower labor costs combined with quality and compared with other countries will remain Portugal with its competitive advantage (Mellery-Pratt, 2015). In Portugal, Zara has established wholly owned subsidiaries with 100% ownership over the 46 open stores (Annual Report, 2006). Over the time, the number of stores increased and nowadays Zara has 81 stores in Portugal (International presence).

France

On the European market, the company's next destination for expansion abroad was Paris, France, the world center of fashion. In 1990, after penetration in the US market, followed with slogan "*the success in the US means that success is possible anywhere*", Zara continued with home region (according to Annual Report: Europe is considered as home market) expansion, and opened the first flagship store in Paris, on rue Halévy, the famous shopping and city center (Inditex history). Furthermore, this geographically and culturally closer host market ease the internationalization and adjusting process due to similar customer's habits and preferences. At the same time, Zara faced with very competitive market due to the fact that all fashion retailers perceive existence on the French market as a huge step stone for further business activities. In addition, some very famous brands which models Zara is replicating successfully and offering at affordable prices are coming from France (Louis Vuitton, Dior).

As Paris being for many years fashion Mecca, all important fashion events and shows occurred there, which granted Zara with closer insight and faster replication of new trends, and subsequently retaining the competitive advantage. Through internationalizing on such highly competitive markets, Zara gained needed knowledge, essential for the future expansion and got the opportunity to learn more about the competitors (Lopez & Fan, 2009). The company´s biggest European competitors (H&M, Benetton) will be reviewed subsequently.

Until 2006, Zara possessed the ownership over the 90 stores in France (Annual Report, 2006). Establishing the wholly owned subsidiary was the entry mode Zara mainly used for developed markets where company enjoyed full control and perceived low risk of maintaining the business activities (Lopez & Fan, 2009).

The period from 1990-1999 on European markets was annotated with continued gradual internationalization of Zara. The company penetrated in approximately two markets each year, expanding the number of stores and increasing the ownership.

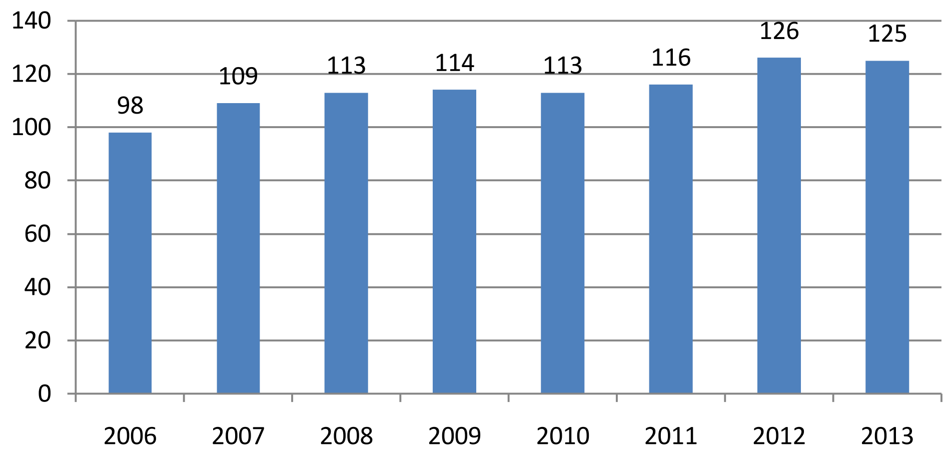

Figure 15- Overview of Zara's stores in France (Source: authors' creation based on ARs)

Although at the beginning of internationalizing Zara entered on very similar markets in terms of psychical distance, in continuous learning process gained new knowledge was used for the next market which was more similar to the host than home market. The best example of that was penetration on Belgium market in 1994 (four years after France), which was very similar to the French previously entered market and concept of maintaining business. In addition, considering Belgium as the potential market, by the end of 2006 Zara had 18 stores in ownership (Annual Report, 2006).

The UK

Following the same principles, after the decision is made for the particular market, Zara continued with opening flagship store in the city center. The same pattern was used in the UK in 1998, and opening the store in London, on Regent Street, around 1,800 sq. m (Annual Report, 1998) preceded to opening others stores in different parts of United Kingdom. This is known as "oil stain" strategy, which begins with opening a flagship store in the capital city. According to this strategy, over time, after gathering some experience at the host market and developing, the company is continuing with opening stores in adjoining areas (The International Growth Of Zara Marketing Essay, 2013). At the end of 2013 in the UK Zara had 66 100% owned stores.

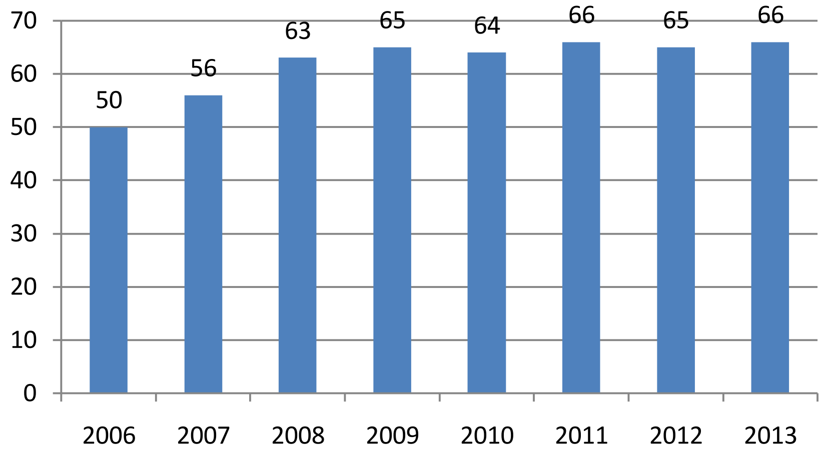

Figure 16- Overview of Zara's stores in the UK (Source: authors' creation based on ARs)

The UK market is equally important and challenging for Zara. This is primarily related with the flexibility of the product development and merchandising, which the company used as an advantage to adjust faster on the UK market. In addition, aiming to exploit mentioned advantages, Zara developed more fashionable lines and customized prices to the British market.

As the UK market being highly competitive, the company has to deal with European competitors coming from other countries to this developed and mature market and domestic competitors at the same time. The world famous British fashion retailer Topshop is operating since 1960 and possesses around 300 stores only in the UK (Our brands- Topshop).

Still, Zara's brand is appreciated and recognized on this market. It enjoys a high popularity among all classes. In support of this, even the Duchess of Cambridge, Kate Middleton wore Zara for a day of engagement (Murphy, 2014).

Germany

In some larger and competitive markets, within Europe, where the company faced with certain barriers in establishing wholly owned units, joint ventures with local companies were formed. This type of cooperative strategy was suitable particularly for the markets where Zara was challenged with acquiring the property and therefore was forced to establish the collaboration with local company. Furthermore, in Germany Zara established JV with Otto Versand in 1999 (Our history). Otto Versand is German's famous and one of the largest catalog-based retailer and the biggest mall owner (The History of the Otto Group). Moreover, Zara's German partner has been established in 1949, and in 2000 was pronounced as the worldwide number two in B2C activities. The Zara's entry in one of the biggest European market in 1999, through the JV ensured opening stores in two big centers in first year of expansion: Cologne and Hamburg. Subsequently, through the host market's partner Zara could easily place products to existing customers via already established distribution channels. Following the market-based pricing strategy affected Zara's positioning in international market. As Germans are perceived and known as price sensitive and less fashionable nation, on the German market Zara has been classified as brand image for upper classes.

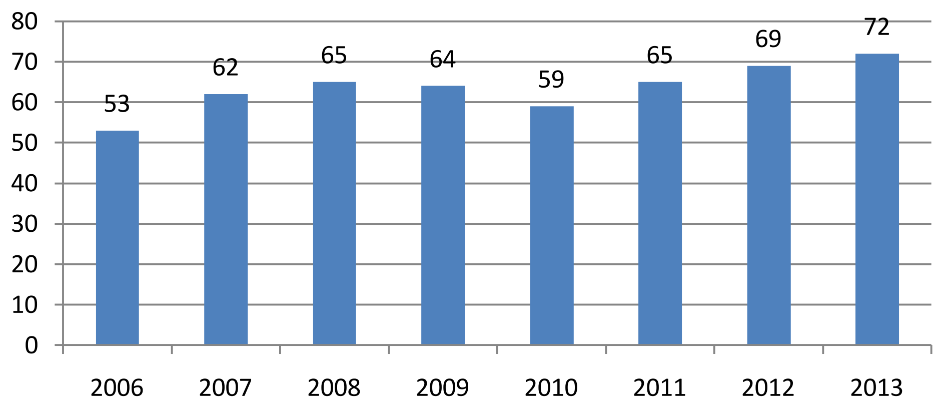

Figure 17- Overview of Zara's stores in Germany (source: authors based on ARs)

Since Zara's business model is characterized with high degree of control and flexibility, the company's goal is to maintain fully control over the operations. Hence, soon after forming the joint venture on different markets the group was aiming to acquire partner's share. In 2006, Inditex reached an agreement to buy 28% of the capital of Zara Deutschland, Inditex's subsidiary which manages the whole German operations, from the German group Otto. In this way, Inditex stockholding in joint venture raised from 50% to 78%, while the Otto Group retained the remaining 22% (Annual Report, 2006). At the end of 2013 Zara had 72 stores opened in Germany.

Italy

Another European joint venture activity Zara formed in Italy. Faced with several obstacles, such as administrative barriers which speeded up company's decision to engage in cooperative business unit, in April 2001, Zara signed joint venture agreement with Italian partner Percassi Group. Italian partner is one of the world leaders in the management and development of sales networks for major international brands (Percassi).

Formed cooperation led to opening the first Italian store in another fashion capital- Milan.

This period was the peak of Zara's expansion during which many stores were opened in different European markets. In addition, after the joint venture has been formed, Inditex Group possessed 51% of ownership in Italy. This occurred at the beginning of 2004: Inditex possessed 51% of the share capital of Zara Italia, S.R.L., and two months after reached an agreement with the other shareholder (the Percassi Group), whereby it acquired a further 29% (Annual Report, 2004). Furthermore, after the agreement reached with Gruppo Percassi to purchase the 20% of capital, Inditex controls 100% of the companies with which it is present in Italy. In 2013 Zara owned 91 stores in Italy (Annual Report, 2013).

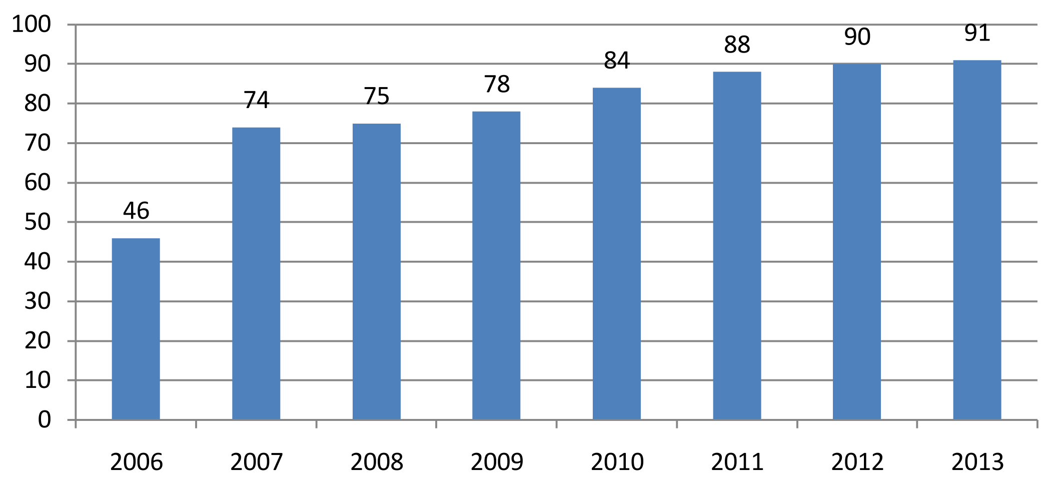

Figure 18- Overview of Zara's stores in Italy (source: authors based on ARs)

The significance of operating on Italian market was recognized by Zara. In addition, Zara store in the Italian fashion capital has enjoyed great sales success since it opened in April 2002. In

2006, the first Zara store was reopened at the attractive location on Corso Vittorio Emanuele II in Milan.

The Italian market is quite similar to Spanish in terms of geographical and cultural proximity. This, however, ease the entering process as the company is capable to understand business conditions and market preferences. As Italy for many years is center of world fashion, Zara faced with extremely competitive market and strong domestic brands. One of the largest European competitors for Zara is Benetton, fashion retailer established since 1965 (Benetton- history)

Zara's presence in the rest of European markets/ROE

With establishing units in Estonia, Latvia, Lithuania and Romania (officially, Romania joined EU in 2007) in 2004, Zara ensured presence in all the EU member countries (Annual Report, 2004). In spite the fact that in majority European markets, Zara was opening its own stores, in 2004 while penetrating on Baltic and South East European markets, strategy changed slightly. Due to the fact that mentioned countries recently became EU members, and therefore their economies were in transition period, those markets are perceived as more risky. In addition, those are small markets with low predicted sales of volume, and yet lacking historical facts about developed fashion industry. However, all Zara's franchising activities were built on the same principles. It means that locations of stores, logistical principles and product assortment remaining the same as in the wholly owned subsidiary. An arrangement with franchisee allows Zara opening the new store at the same location (Castellano, 2002).

The first Zara's franchising agreement was established in Malta, 1995 (Inditex history). Afterwards, this type of agreement Zara used mainly in small markets which are not generating high profit. From the perspective of Zara's expanding timeline, those markets were entered in period when company could "afford" entering several markets at the same time, some of them culturally distant, with certain level of risk.

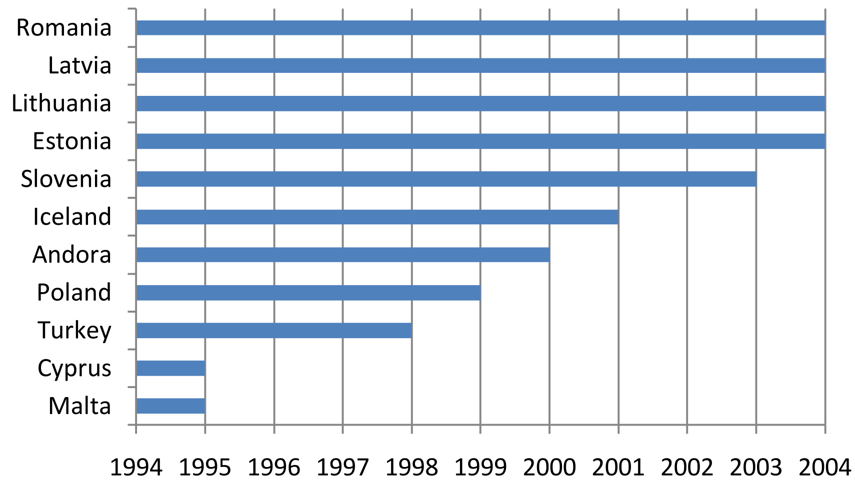

Figure 19: Franchising agreements in ROE (Source: authors' creation based on ARs)

Zara's key markets in the Americas region

In the following chapter Americas region's significance for Zara will be examined. The most relevant markets, in terms of size and number of stores will be reviewed. In addition, customer preferences, fashion trends and market conditions will be analyzed as well as operation modes company applied while penetrating.

The fashion industry has its roots in Europe and North America. Therefore, European, American and Canadian markets can be considered as a driving force in the development of the fashion industry (Keenan, et al., 2004). Americas region has been a very important region as it was the first market with great psychic distance Zara entered.

In the dissertation, Americas region includes North America and South America countries. Zara entered this region in 1989 by opening its first store in the U.S. By 2014, Zara has expanded into 18 countries in Americas region including following North America and South America countries: USA, Canada, Mexico, El Salvador, Costa Rica, Panama, Puerto Rico, Dominican Republic, Guatemala, Honduras, Brazil, Columbia, Argentina, Chile, Peru, Venezuela, Paraguay and Uruguay.

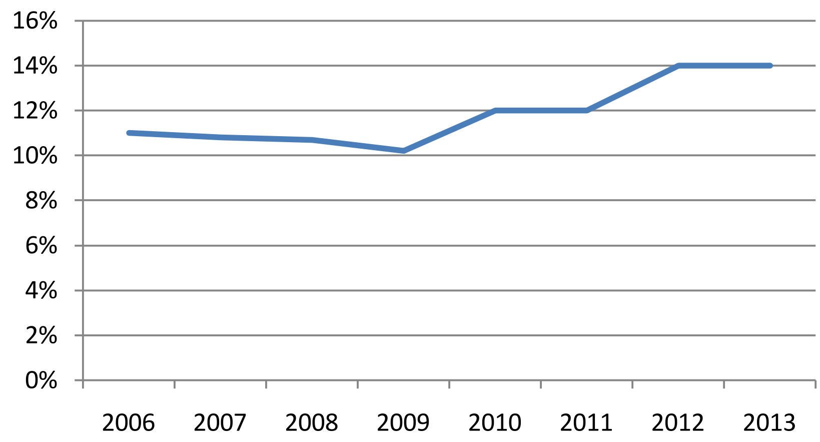

Figure 20- Inditex sales share in Americas region (Source: authors' creation based on ARs)

For Zara, Americas region also is an important region. Inditex Group's sales share of the region in 2013 was 14%. Nowadays Zara operates in 256 stores within 18 countries in North America and South America (International presence). USA, Canada, Mexico, Brazil, Argentina and Venezuela are the most important Zara's markets in the region. International expansion patterns in these countries will be described more in details in this chapter.

United States of America

The first market Zara entered outside Europe was USA. In 1989 Zara opened its flagship store in New York, one of the fashion capitals. The store was established as a wholly owned subsidiary despite that it was not considered a financially beneficial move. Zara entered USA because of strategic reasons (Global Expansion- Zara, 2012). The goal was to expand to one of the major international markets in order "*to build brand awareness and international prestige and to get close to fashion trends*" (Bonache and Cerviño, 1996; Martinez, 1997, cited in Lopez, 2009). Moreover, Zara gained an opportunity to learn about its main American competitor Gap and consumers in a distant and highly competitive market.

Inditex Group has been criticized for slow expansion in the United States and not taking advantage of capturing customers in a significant market by offering fashion items in plus sizes (Vincent et al., 2013).

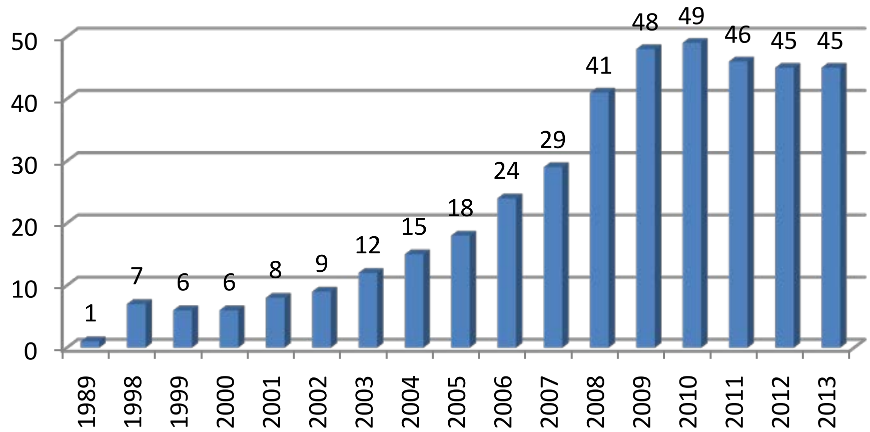

Figure 21- Overview of Zara's stores in USA (Source: authors' creation based on ARs)

In USA Zara has expanded cautiously by gradually increasing number of stores until 2007 (see figure above). By early 2000s Zara had only six stores in USA (Vincent et al., 2013). Despite approval of the consumer Product Safety and Improvement Act in 2008 that allows importing only certificated clothes in the United States, Zara more rapidly increased number of stores during year 2008 and year 2009. In 2010 Zara was operating in 49 stores. However, the number of stores is not sufficient in order to cover the whole American market. It is estimated that it is necessary to have approximately 300 stores to cover the United States (Nisita, 2012).

In order to cover the whole country and more available, in 2011 online sales platform were launched with shipments to all 50 states (Annual report 2011).

Zara has announced plans to expand more rapidly in USA. By the end of the year, Zara will have eight stores in Manhattan and seven in the biggest metropolitan areas. In 2015, Zara plans to open stores in Los Angeles, Las Vegas, San Diego, Boston, Houston, Dallas, Chicago, New Jersey, Seattle and the US territory of Puerto Rico. Zara's growth model for American market foresees opening a number of flagship stores and increase online sales (Mellery-Pratt, 2015a).

Zara stores are typically located in prominent and highly visible places for instance on the premier shopping streets like Fifth Avenue in Manhattan and upscale shopping centers (Ghemawat and Nueno, 2006). In 2012, the new concept of Zara store was presented on Fifth Avenue. The image of a new store concept includes four principles: beauty, clarity, functionality and sustainability. The main characteristic of store is simplicity. The goal of the new concept is to facilitate establishment of direct contact between the customers and fashion (Annual report, 2012).

Differences in customer demand have impeded Zara’s expansion into United States. Zara sells trendy and slim fit clothes. Outside the biggest cities, Americans demand classic and roomier clothes (Zara, Spain’s most successful brand, is trying to go global, 2012). Moreover, customers in USA are less fashion focused than in Europe (Ghemawat and Nueno, 2006). Customers that more care about fashion live on the East and West coasts, but rural Americans are less concerned about fashion in comparison to rural Europeans (Nisita, 2012). Expansion in America is complex also because most of the stores are placed in shopping malls outside the cities.

Americans are used to aggressive marketing campaigns. It is contrary to principles of Zara. By having visible campaigns, Zara could get better acceptance in USA and increase brand awareness.

It can be inferred that the psychic distance that includes differences in customer demands and values had had a certain influence on Zara’s pace of international expansion and selection of entry strategies in USA. In order to overcome psychic distance and keep control over foreign operations Zara has entered United States with wholly owned subsidiaries. This choice can be justified also by significance of market. Moreover, the business model of Zara requires having a great control and flexibility. The business model of Zara requires ensuring short production time and frequent store replenishment with new items as it is in Europe. It means that in order to support rapid expansion in USA Zara would need to have to extend product line with big sizes and open a new distribution center closer to American market.

Canada

In June 1999, Zara entered Canada, the second most important market in Americas region. At that time, Zara had international experience and started to expand in markets that are more distant. Zara and other fast fashion retailers brought to Canada and North America a new concept by demonstrating their ability to change their merchandises twice a month.

In July 1999, Inditex Group started a joint venture with Reitmans with a creation of "Zara Canada Inc.". The goal of the joint venture was to open Zara stores in the Canadian market (Reitmans Canada, 2000). Inditex Group owned 95% of shares of "Zara Canada Inc." Acquiring knowledge and becoming familiar with the Canadian market, Zara decided to buy out remaining 5 % of the Canadian group in 2002 (Annual report 2002). Thus, Inditex Group became a sole owner of the Canadian company. It can be noticed, that after gaining the full control over "Zara Canada Inc." Inditex Group started to expand in the market more rapidly.

Similar as in the United States, Zara's expansion into Canada were slow, despite that it entered the market in partnership with the local clothing retailer Reitmans. First Zara store in Canada was opened in Montreal in December 1999 (Reitmans Canada, 2000). In April 2000 stores in Toronto and Vancouver were established using the stores left by Marks and Spencer withdrawal from the Canadian market (Inditex Group- El Rincón del Vago). During the next years, the number of stores was gradually increased. By 2007, Zara operated in 14 stores (annual report 2007), but until 2014 the number of stores reached 25. In April 2013, Zara launched online sales in Canada, thus becoming more available (Inditex Report, 2013).

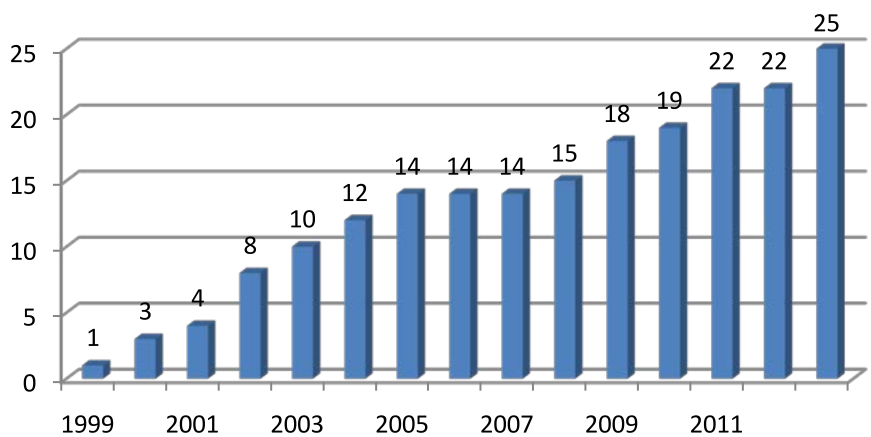

Figure 22- Overview of Zara's stores in Canada (Source: authors' creation based on ARs)

It can be inferred that in order to overcome liability of foreignness and reduce psychic distance, Zara entered Canadian market in partnership with a well-established Canadian retailer. By having majority of shares, Zara wanted to keep stricter control over its stores and maintain existing business concept. The partnership was used in order to facilitate access to the Canadian market and acquire partner’s knowledge. Redemption of shares and further expansion shows that Zara considers the Canadian market to be important.

Mexico

Few years after expansion to the United States, in 1992, Zara opened its first store in Mexico. In spite of geographical distance, this market is psychically close to Spain due to common language and religion. Moreover, Mexican consumers are seeking less expensive ways how to adopt the fashions of developed countries (Ramey, 1994 cited in Bhardwaj et al, 2011). Moreover, by entering Mexico Zara moved a step closer to the South American market (Lopez and Fan, 2009).

Zara was interested in Mexico also because of economic reasons. It is a big market with almost 90 million inhabitants. Zara’s target group was upper class and middle class (The international growth of Zara marketing essay, 2013) that was the smallest part of population in Mexico. Therefore, Zara’s products were presented as high- end goods emphasizing that they are “made in Europe”.

Despite similarities between Spain and Mexico Zara as entry strategy for the country selected joint venture (Quinn and Biondi, 2012). Zara rather quickly expanded in Mexico. In 1998, Zara had 18 stores in Mexico, which was the highest number of stores in Americas region (Annual Report, 1998). At this moment, Zara manages almost 60 stores in the major Mexican cities.

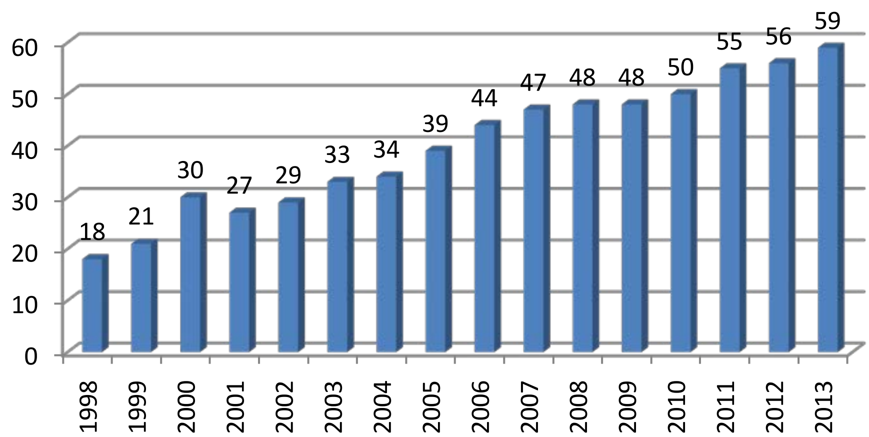

Figure 23- Overview of Zara’s stores in Mexico (Source: authors’ creation based on ARs)

Last year, Zara launched e-commerce platform in the country, thus expanding its operational marketplace (Zara rolls out e-commerce platforms for Mexico, 2014). Inditex Group has established a relatively small distribution center called satellite site in Mexico, in order to consolidate shipments from the main distribution center located in Spain (Ghemawat and Nueno, 2006).

It was noticed that Zara sought for suppliers in Mexico (Slashed import tariffs bring cheap foreign brands to the middle class, 2012). Inditex owns 50% stake in the Tempe Group that has subsidiaries in Mexico, Brazil and other countries. The company is involved in footwear production to Inditex Group companies (Annual Report, 2011).

Brazil

Brazil is the biggest retail market in Latin America. Zara entered the Brazilian market in 1999 by opening four stores (Annual report 1999). Brazil turned out to be one of the most challenging markets Zara operates in due to bureaucracy, logistics, taxation and access to skilled labor. These factors were the main reason why Zara could not achieve its initial plan to open 50 stores within 3 years (Grimberg, 2014). Moreover, the price of clothes in Brazil is much more expensive than in the rest of the world due to high import duties (up to 140% of a product value) (Monteiro and Andrade, 2014). High import duties impeded Zara from more rapid expansion, since it had to target the wealthy public in order to maintain target margins (Ibid).

Fashion retailers coming from Northern hemisphere face another challenge when operating in Southern hemisphere due to different seasonality. This means that retailers have to be able to offer summer and winter lines at the same time. It has been found out that customers follow the newest fashion trends and, therefore, do not want to buy clothes from the previous season (Johnson and Felsted, 2011).

Despite challenges described above, Zara entered the Brazilian market by establishing wholly owned subsidiary (Monteiro and Andrade, 2014). The number of stores were increased gradually mostly by opening 2-3 stores each year. Zara wanted to keep the same business concept as it has in Europe and deliver clothes in three days. However, it could not achieve that due to poor infrastructure and slow customs process. In order to overcome logistics and import problems

Zara opened a 40,000 m2 big logistic center in São Paulo. It was the first distribution facility located outside Spain. The distribution center ensured supplies to other Zara stores located in Argentina, Uruguay, Chile, South Africa and Australia (Monteiro and Andrade, 2014).

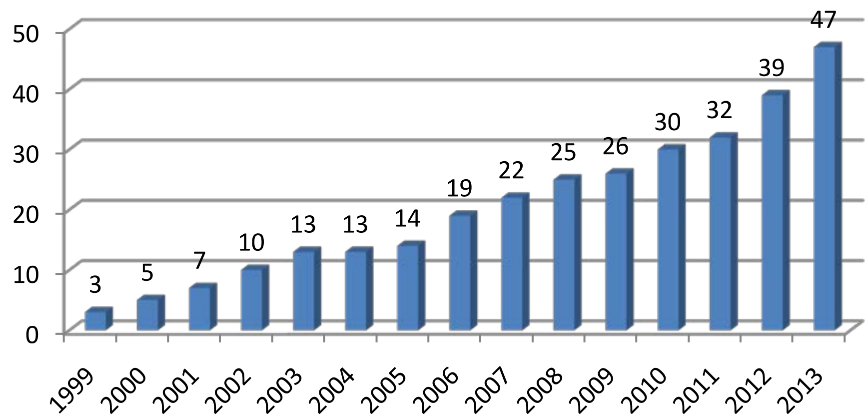

Figure 24- Overview of Zara's stores in Brazil (Source: authors' creation based on ARs)

Despite difficulties to find reliable and decent quality suppliers, Zara is sourcing 40% of its products at the local market from approximately 50 different suppliers (Monteiro and Andrade, 2014). Additionally, Inditex Group has established joint venture in Brazil to produce footwear for the Groups' stores. Inditex owns 50% of shares in Brazilian company (Annual Report, 2011).

Inditex Group has been accused for accepting slave- labor working conditions at its outsourced plants in Brazil (Antunes, 2011). In order to prevent recurrence of such situations Zara has established business clusters in several countries including Brazil. The clusters are made to facilitate collaboration between suppliers, manufactures and trade unions, business associations and international purchasers in order to improve working environment and promote sustainable production principles (Annual Report 2011).

Argentina

Zara started to expand into South America in 1998 by entering Argentina first (Lopez and Fan, 2009). Argentina has been used as a springboard for expansion into Latin America due to the similarity between Argentinean and European customer preferences. The country was opened to

FDI and, therefore, Zara entered market by establishing wholly owned stores (Lopez and Fan, 2009). The market was considered to be attractive because there is high per capita spend in apparel and high concentration of inhabitants in urban areas (Bowles, 2012).

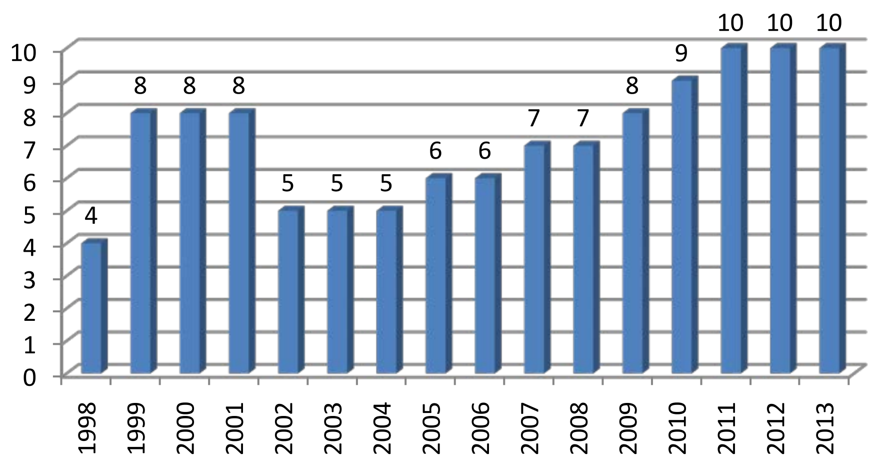

Figure 25- Overview of Zara's stores in Argentina (Source: authors' creation based on ARs)

Zara expanded in Argentina cautiously. In 1998 it was operating in 4 stores, but in 2013 number of shops increased only to 10 (Annual Report, 1998 and Annual Report, 2013). Zara has established a distribution center in Argentina in order to cope with distance and seasonality differences in the Southern Hemisphere (Ferdows et. al, 2003). At the beginning, Zara was applying ethnocentric approach by replicating strategies used at the home market when expanding into foreign markets (Bonache and Cerviño 1997 cited in The International Growth Of Zara Marketing Essay, 2013). However, over the time it moved towards geocentric approach and started to adapt to host markets needs and requirements. Mostly Zara sells homogeneous fashion items all over the world (Flavian and Polo, 2000). Nevertheless, it is making adjustments in products due to customer needs in terms of sizes and legal requirements. For instance, in Argentina Zara has to offer clothes for youths in all sizes due to local laws (La Opinion de La Coruña, 2006, cited in Lopez and Fan, 2009).

Also in Argentina Zara has been accused for use of unfair labor practices (Zara uses slave labor in Argentina, 2013, Crotty, 2013). This leads to an establishment of business cluster in the country. Inditex Group is investing in workforce education and executing control over suppliers' production sites in order to make sure that they comply with the Code of Conduct for External Manufacturers and suppliers of Inditex (Annual report 2011).

Venezuela

Venezuela has been among first Latin America markets Zara entered back in 1998. Zara has increased its presence in the market gradually. In 2007, Zara had 11 stores in Venezuela. In the beginning, all stores were established as wholly owned subsidiaries. However, due to frequent changes in government policies and import restrictions Zara changed the ownership of its stores. The growing aversion from Venezuela's government part to Spanish interests due to incident in the closing session of the Ibero-American summit in Chile in 2007, when King of Spain Juan Carlos said "*Why don't you shut up!*" to President of Venezuela Hugo Chavez, forced Zara to sell its stores to local company by signing a master franchise agreement[8] (Buena, 2013).

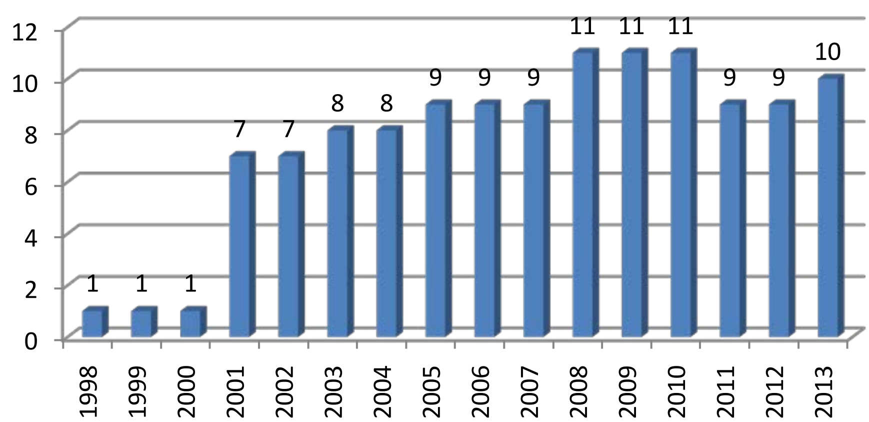

Figure 26- Overview of Zara's stores in Venezuela (Source: authors' creation based on ARs)

Zara closed two of its stores in 2011 due to new legal requirements in Venezuela. The Government of Venezuela passed a law that limited the purchase of dollars from central bank and the Fair Price law that limited profit margin down to 30% for all sectors that import goods from other countries (Smith, 2014). In order to comply with law prices in Zara stores were

[8] The master franchise agreement gives rights to the master franchisee to own and operate more than one store, and the right to sub-franchise the right to open new stores to other independent businesses (called franchisees)

reduced by 50 per cent (Tallantyre, 2014). Growing demand for Zara's products after introducing low-cost ranges created long queues at its stores. As a result, Zara was forced to restrict customer purchases to five items per month by introducing special customer ID numbers (Ibid).

Zara's expansion into rest of Americas region

Besides countries presented above Zara is present in following countries in the Americas region: Chile, Uruguay, Dominican Republic, El Salvador, Panama, Costa Rica, Peru, Puerto Rico, Colombia, Guatemala, Honduras and Ecuador (Annual report 2013).

Only in two countries Zara has opened more than 2 stores- in Columbia it operates in 11 stores, and in Chile- 8 stores. In the rest of countries, it has only two or one stores.

Columbia is an attractive market because it has around 30 intermediate cities with population over 200.000 people. The apparel retailing market is one of the most important contributors to economic development. The main obstacles for rapid expansion could be fluctuating currency exchange rates, heavy taxes, costly logistics and legal system, and political instability (Young, 2014).

After Zara's entrance in Columbia, other fashion retailers started to show interest to invest in the country. Columbia has its own textile producers that created distribution networks that facilitated foreign company expansion in the market. Columbians are very conservative when it comes to fashion. However, they are slowly adapting to world fashion trends after opening up of the market (Ibid).

Zara entered the Columbian market in 2007 by opening four franchised stores (Annual Report, 2007, Quinn and Biondi, 2012). Zara has cautiously expanded in the country by increasing number of store up to 11 in 2013 (Annual Report, 2013).

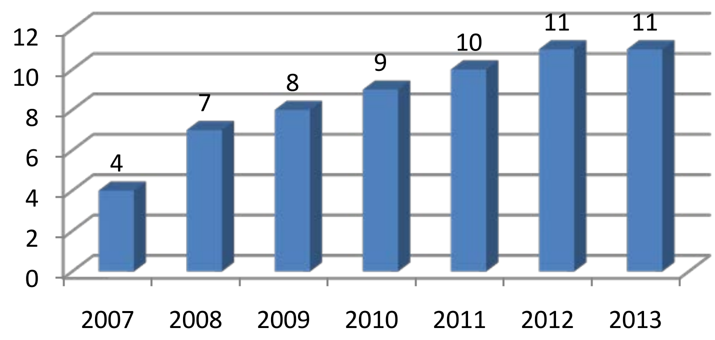

Figure 27- Overview of Zara's stores in Columbia (Source: authors' creation based on ARs)

Zara entered the **Chilean** market in 1999 by opening two wholly owned stores. The low apparel consumption compared to Europe and USA (Bowles, 2012) has had an influence on Zara's further expansion in the market. Moreover, Chileans are considered to be less fashionable as for instance Argentineans. Customers in Chile prefer much more conservative and more standard clothes compared to Europeans (Mount, 2012). However, Chileans are more becoming fashion conscious (Bowles, 2012).

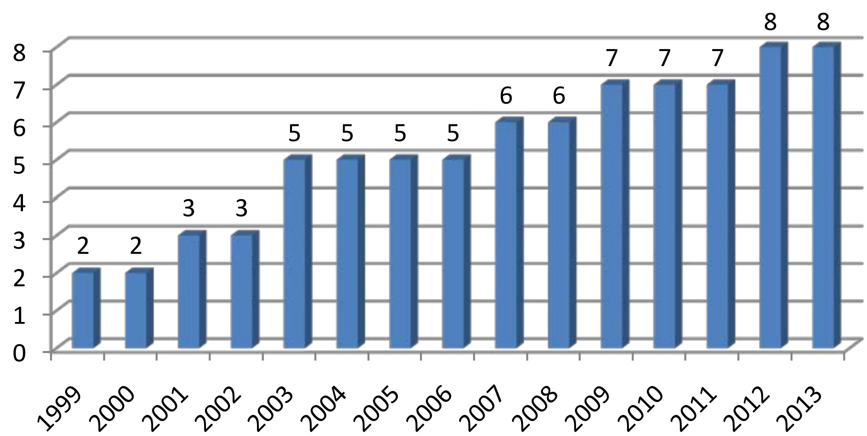

Figure 28- Overview of Zara's stores in Chile (Source: authors' creation based on ARs)

Zara has entered **Uruguay and Puerto Rico** by opening own stores in 1999 and 2005 respectively (Annual Report, 1999 and Annual Report, 2005). Uruguay is one of the fastest growing markets in Latin America with strong economic indicators such as one of the highest per capita disposable income (Bowles, 2012). However, it has small population that is mostly concentrated in urban areas. A small population leads to small apparel market, thus, influencing fashion retailer expansion. Similar to Uruguay Puerto Rico has small population. However, it is a high- income country according to World Bank classification (Puerto Rico) and one of the most competitive countries in Latin America (Schwab, 2013). The use of United State Dollars as a national currency also facilitates incoming FDI. Therefore, it is not surprisingly that Zara has chosen to open wholly owned stores in both countries.

In other countries- Dominican Republic, El Salvador, Panama, Costa Rica, Peru, Guatemala, Honduras and Ecuador- Zara has used franchising as an entry mode. These markets are quite small compared to other countries in the region. The number of Zara stores is low. Zara has opened only one or two stores in these countries (Annual Report, 2013).

Zara's presence in Asia and Rest of the World (ROW)

The goal of following chapter is to provide with overview of Zara's main markets and business conditions in Asia and Middle East. Several most relevant markets will be described as well as governances' regulations and clothing traditions the company experienced. As those markets are culturally and geographically distant from the company's home market, the main challenges Zara faced will be underlined.

For Zara, Asia represents second most important geographical area, from the perspective of both: number of stores and sales share. In 2013, recorded sales share in Asia was 20.4%, right after Europe, the region with the largest sales share. In a recent period, the significance of Asian market increased for Zara, due to saturation of European and US markets. In addition, the effects of world crisis left the traces on Western markets. The first penetration on mentioned markets, Zara did in 1997 through establishing franchising agreement on Middle East region, in Israel. Nowadays, Zara has operations in more than 450 stores, within 26 countries in Middle East and Asia (Annual Report, 2013). In addition, on two markets: Japan and China, Zara formed online sales platforms, as a respond on increased online sale and to satisfy large population markets' needs.

As key markets in Asia and ROW (rest of the world), the following are considered: China, India, Israel, Japan, Saudi Arabia and South Korea. Those are markets with largest numbers of stores and high development potential. Furthermore, the significance of those regions is even bigger with the fact that in 2013 around 30% of suppliers were coming from Asia and Africa (Annual Report, 2013).

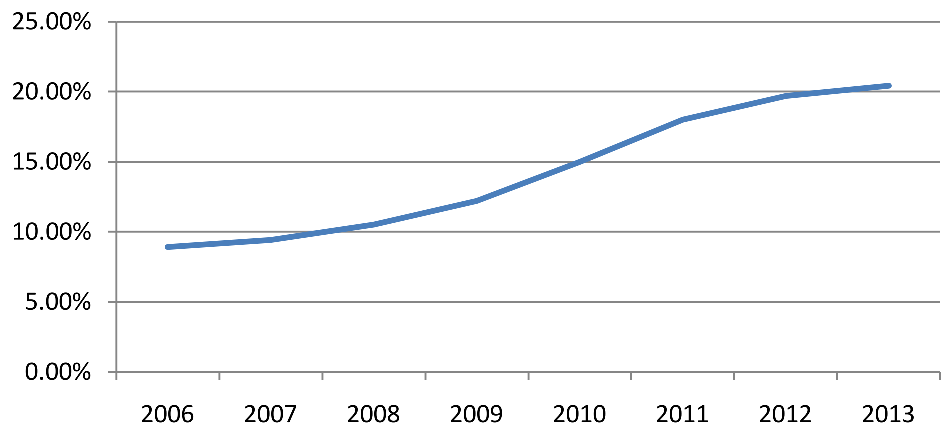

Figure 29- Inditex sales share in Asia and ROW (Source: authors' creation based on ARs)

Zara's main mission on Asian markets is to influence buyers' perception of the quality of Zara's clothes. This is resulted with the fact that company cannot compete with local retailers, and, therefore, the accent is on quality of clothing.

China

Zara's Chinese adventure started in 2006, with opening the flagship store in Shanghai. According to previously established company's strategy this was a step stone for expansion and opening stores in "secondary" cities. Among several Asian markets, China is the most important for Zara, as this is the second biggest market, after Spain (Oliver, 2014). By penetrating on Chinese market, Zara faced with large number of customers and possibility for additional exploiting the economies of scale. The main arguments Zara considered prior to internationalization in China are: labor and distribution cost, and productivity.

Furthermore, this market is characterized with skilled labor and emerging of new middle class with growing purchasing power (Pan et al., 2011). In addition, low salary wages in this area, ensures lower costs of production which led to engaging around 30% of suppliers from Asia. In spite to that, Zara continued applying the price discriminatory strategy in different regions, by determining different prices for the same products on different markets (Wei, 2008).

While entering on Chinese market, Zara was penetrating at the same time on several markets in other regions. This lead to conclusion that company gained sufficient market experience to be capable to meet the challenges and satisfy customers' demand in different geographical regions in a short period of time.

Besides financial aspect and profitability of opening stores in China, Zara deliberated macro factors and regulations. Since this region being very open for foreign investments, through the government initiative that leads to decreasing of unemployment and gaining of know-how, Zara faced with weak barriers and flexible regulative (Wei, 2008). This is mainly resulted with Chinese government´s effort to attract foreign companies and their investment, in order to decrease unemployment rate and involve Chinese companies into different types of business arrangements with foreign investors.

However, Chinese market is also challenging for Zara. The main reason for that is intensive presence of the biggest European rivals, which also sources a significant percentage of products from this market.

As Chinese population being extremely large (around 1.3 billion people (China Population)), this market has a huge potential for online sale. This is primarily due to expansion of e-commerce in Asia, and subsequently China as well as rise in number of online customers.

As mentioned, significant percentage of Zara's suppliers is placed in China. The great focus in Zara and subsequently Iniditex Group is on grouping suppliers into clusters, with purpose of improving working conditions within each cluster (Annual Report, 2013). In total, there are ten clusters over the world. The clusters contain almost 90% percent of group production.

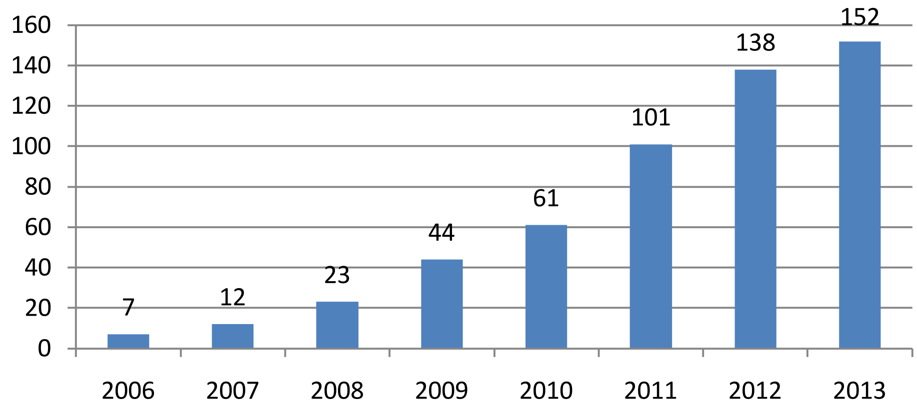

Figure 30- Overview of Zara's stores in China (Source: authors' creation based on ARs)

Zara´s stores in China are 100% owned by Inditex Group (Annual Report, 2012). From the time first store was opened in China, Zara achieved a great success. The pace of expansion on Chinese market was rapid, what is shown in the stores' overview (figure above), where Zara doubled number of open stores from period 2008-2009. This is resulted with Zara's answering on customers' needs in a short term. Moreover, in highly populated markets that can ensure more success, with constanly changing trends Zara could reach more fast fashion consumers. Furthermore, established production facilities are improving knowledge gaining about the market, as designers which are strongly linked with production are equaly introduced with customers' preferences.

India

The Indian market Zara penetrated by establishing joint venture with Trent Limited, company owned by Tata Group, very well-known clothing line distributor in India. According to this agreement, Inditex Group holds 51% of the collaboration, and Indian partner has a share of 49%. This type of agreement is required by Indian government which insists on possessing 49% of share by resident company, in case when foreign single-brand supplier is entering the market (Entry Mode of Zara into the Indian and Chinese Market Business Essay, 2013).

In addition, Zara used joint venture as entry mode in large and competitive markets, where Zara´s know-how and experience could be combined with facilities and knowledge about host market domestic partner possesses. However, Zara did not success in opening many stores in India as in other markets. This is primarily due to strict Indian policy regarding foreign investments and property acquiring, which affected company´s pace of expansion on this market and forced Zara to collaborate with local company. The joint venture agreement helped Zara to build relationship with customers and establish the distribution function (Lopez &Fan, 2009).

Zara´s first store was opened in Delhi, and afterwards in Mumbai. Those are the largest cities with urban population, which represents the majority of Zara´s customers. This is also in accordance with Zara's strategy, to enter the country and get the knowledge about the market and subsequently to expand (Roy, 2010).

Indian market is very significant for Zara. The main challenge Zara faced on Indian market is with regard to customers´preferences and fashion trends. Furthermore, company applied strategy of combining local and international clothing lines, respecting cultural specifity and offering fashionable international clothing for habitants with Westerns orientation.

In order to reach huge Indian market, with population around 1.2 billion people, Zara focused on promoting campaign. Although this practice was not previously used by Zara (as the company´s advertising costs are less than 0.3% of revenue). In India, Zara made promotion through video advertisments and print ads. This was primarily focused on the particular target group company wanted to reach: teenagers and "*those who are considered as young at heart*" (Entry Mode of Zara into the Indian and Chinese Market Business Essay, 2013).

The significance of Indian market for Zara could be understood from the perspective of knowledge gaining. As mentioned, this market is challenging for the company from many aspects. One of them can be the fact that seasonable changes in assortment are not the biggest advantage on this market. This is primarily due to the fact that in some parts of India there is no winter.

In addition, the largest experience company will gain on this market is regarding cultural characterisitcs. Majority of Indians still prefer to wear traditional clothes, which is not resulted with fast fashion trends and subsequently it has a longer lifetime. Furthermore, in this part of world colors play a role. There is a demand for strong and open colors which usually simbolize life, in spite of existing trends in most of Zara´s assortments where black and white are main colors (Smith, 2013).

Nevertheless, for Indians Zara´s attendance in India is a link to the Western fashion world (Chatterjee, 2014). Applying the previously developed strategy Zara communicated with customers through its shop windows, changing the offer twice a week and improving the communication between every store manager with team of designers in Spain.

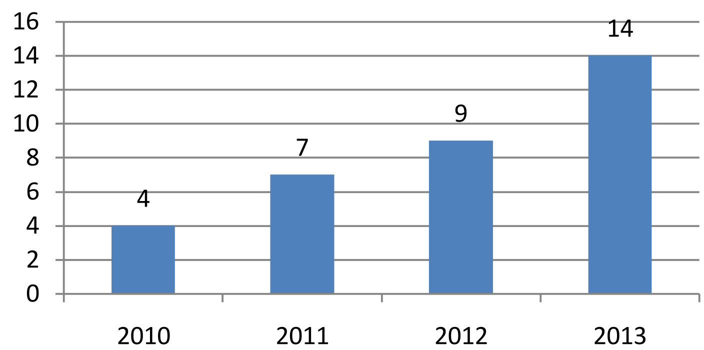

Figure 31- Overview of Zara's stores in India (Source: authors' creation based on ARs)

Zara entered Indian market late (in 2010), comparing with previous group´s expansion, and grew in slow pace. This was resulted with several obstacles that host government is brining for foreign investments and well-know prefered Indian tradition. However, in order to be able to compete with mentioned constraints, Zara needed to gain previous international experience.

Japan

International expansion into the Japanese market, Zara started in 1998, through establishing joint venture with local partner- Bigi Group. Bigi Group is known as one of the biggest Japanese textile distributor with extensive knowledge about the local market and property regulations (Annual Report, 1998).

As mentioned, joint venture is business agreement suitable for large and competitive markets. This model is an option in the situation when foreign company does not possesses extensive knowledge about the focal market and degree of uncertainty is high. Hence, the knowledge and experience local partner might possess can be valuable in the beginning of internationalization on the particular market.

Likewise the previous penetrations, in Japan Zara opened store in one of the prominent streets of Tokyo, Japanese capital. Subsequently, more stores were opened in Osaka which confirms applying “oil-stain” strategy by Zara. In the same period Zara penetrated in several countries. In addition, those countries are placed in different regions, which confirm Zara´s status of transnational retailer, with huge international and market experience gained (The International Growth Of Zara Marketing Essay, 2013).

One of the challenges Zara faced on Japanese market was limitations in usage of larger space and extremely expensive real estates. Thus, collaboration with domestic company was best possible options for the company at that time. Another significant challenge was presence of strong competitors. One of Zara’s largest competitor, Gap has own store in Japan only, while in other Asian markets Gap entered through franchise agreements. Beside Gap, H&M and Marks and Spencer, Swedish and British retailers have strong presence in Japan (Baigorri, 2009).

Zara´s expansion in Japan occurred in fast pace. In average, number of stores was increasing around 15% every year. This is resulted with existing demand and Zara´s efficiency to satisfy customer needs. In addition, Japanese perception of Zara contributes to that. For Japanese, Zara represents the link to Western fashion, although it does not come from US but more traditional Europe. However, aiming to possess everything what symbolize Western way of life, Zara founded demanding market and large target group among young Japanese.

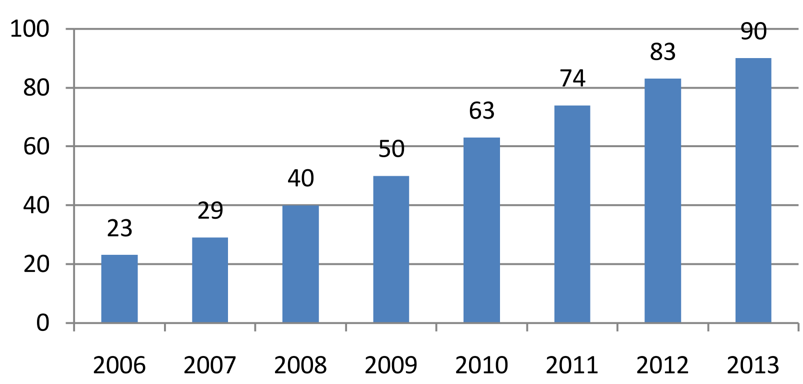

Figure 32- Overview of Zara’s stores in Japan (Source: authors’ creation based on ARs)

The Japanese fashion industry is in behind comparing with European. The domestic apparel industry in declining due to changes in customers' perception and increased interest for European fashion. Moreover, Japanese have allowed to Europeans to present the Western fashion trends, and introduce something that was not seen before. The new trends European designers brought are colorful and different comparing with Japanese traditional models (Rajia).

South Korea

In 2008, Zara established joint venture for entering the South Korean market. Zara Retail Korea became as an agreement between Inditex and Lotte Shopping, with shares 80% and 20% respectively. The joint venture agreement was made due to lack of knowledge and experience on the Korean market.

In April 2008, Zara opened flagship stores on two locations: Lotte Department Store's Young Plaza in central Seoul, and the COEX Mall in southern part of capital, Seoul. Owing to its population size and economic strength, this is one of the most important cities in Asia-Pacific region. The focus was on opening large and representative stores in city centres. This was the proven way of communication with customers.

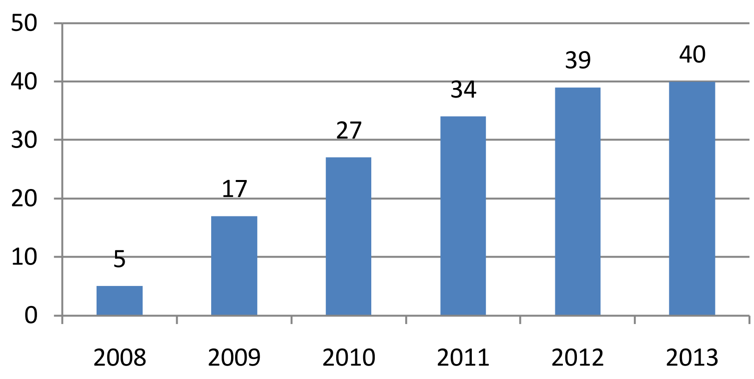

Figure 33- Overview of Zara's stores in South Korea (Source: authors' creation based on ARs)

The strategy Zara applied in Korea is very similar to all on Asian markets. The company prefered to establish joint venture, due to different obstacles and lack of knowledge about the host market. In addition, this agreement with local company supported Zara in gaining the knowledge and getting the new retail locations (Inditex SA, 2008).

As Zara prefers having control over the strong vertical integration, what is not typical for this type of entry modes, organizing logistic and transportation functions from home market usualy lead to constraints. In addition, distribution expenses from home to the host market are affecting pricing chart and determine higher prices comparing with European region, what also can be perceived as challenge in competing with local retailers. Due to the fact that Zara´s products are coming from Spain, the selling price is higher than at the home market. This was another challenge Zara experienced on the Korean market, which led to price decreasing in 2009, up to 30% (Han, 2008).

Beside real stores, on the Korean market Zara opened online store offering the same assortiment and prices as in real stores. In addition, customers have an option to receive the order on home address or one of the chosen stores. In both, real and online stores assortment has changing twice per week (Estopace, 2014).

On the Korean market Zara faced with competition. The presence of US competitor GAP with organized distribution is widely extensive. In spite of established joint venture with domestic partner, Zara´s employees in Korea were not coming from collaborated company. In Korea, Zara chosed employess individualy as the company is planning to educate and train the staff (Park, 2013).

Nowadays, Zara has 40 stores in all bigggest cities of South Korea (Annual Report, 2013).

Israel

Zara started to expand into Middle East in 1997 by opening store in Israel. Israel is a small market; however, international companies like Zara, H&M and others are generating solid profit by selling goods at a higher price. There is an increasing demand for international brands and consumers are eager to pay a premium for brand-name goods (Steinberg, 2011).

The needs of religious Israelites differ from European needs when it comes to clothing. Judaism teaches that body should be covered in public. Therefore, in Israel women wear long skirts and clothes with long sleeves. However, due to increasing women integration into job market, the demand for more convenient clothing is increasing. The dominant color for clothes is black (Chabin, 2010). In order to adapt to different customer preferences Zara introduced a special modest line for religious girls.

Israel is considered to be a risky market due to the problems between Israelis and Palestinians (Inditex Group- El Rincón del Vago). Due to special characteristics of the market, Zara used franchising as an entry mode (Ibid). Despite differences in customer demand, the store turned out to be very profitable. Zara penetrated in the Israeli market gradually increasing number of stores. The first store was opened in the Ramat Aviv shopping mall in Tel Aviv (Crystal, 2009), the second most populous city in Israel. In 2013, there were 22 Zara chain stores across different Israeli cities.

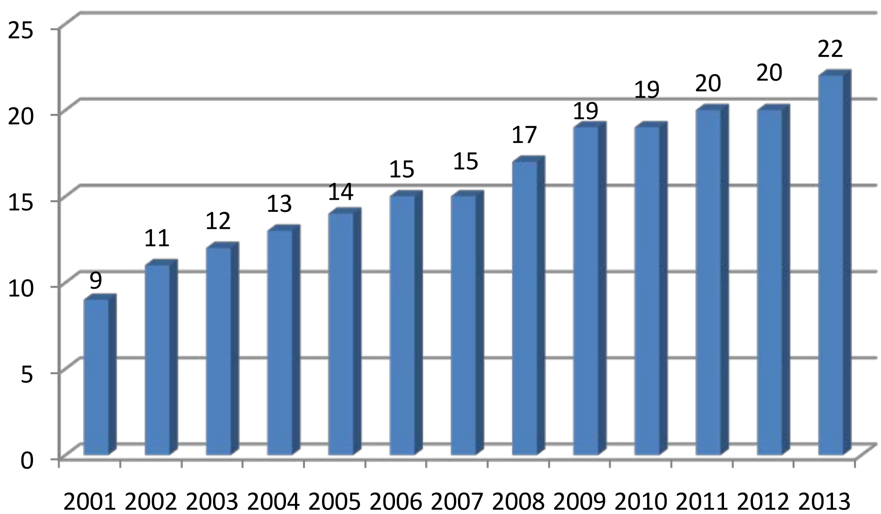

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Figure 34- Overview of Zara's stores in Israel (Source: authors' creation based on ARs)

However, despite of being present in country for 7 years, last year Zara got into trouble when selling sheriff's shirt with a star for kids. Locals in the t-shirt saw the similarity with the uniforms of the holocaust concentration camps. A problem was exacerbated by fact that the t-shirts were produced in Turkey and introduced to market after recent rhetoric from Turkey's President- elect against whom Israelis have expressed dislike over the years (Julian, 2014). As a result Zara had to apologize to Jewish commune and had to withdraw the shirts from their stores worldwide (Cohen, 2014). In 2007, Zara had to apologize to the Orthodox Jewish community for mixing linen and cotton in a suit for men. According to Jewish Bible (The Torah), it is considered to be a serious sin (Zara apologizes for mixing materials in man suit, 2007).

United Arab Emirates

Zara entered United Arab Emirates (UAE) in 1998. The population of UAE's is small (around 5 million). However, it is an attractive market due to high concentration of population in urban areas (80 % of population is urban) and one of the highest consumer spending per capita (Ben-Shabat et al., 2009). Furthermore, the increasing number of emigrants has made foreign culture more accepted. For instance, Dubai is very popular destination for tourists and business, therefore, its population is showing interest in global brands (Ben- Shabat et al., 2009). However, retailers are starting to refocus on meeting needs of local customers, due to increasing number of people enjoying shopping.

Despite the attractiveness of markets, foreign retailers face challenges when trying to enter the country. Foreign companies cannot enter UAE without local partner. The local partners want to have influence on decisions regarding entrant's value chain, including distribution strategies. Thus, usually foreign companies begin expansion with week negotiation power (Ben- Shabat et al., 2009). Mostly European non-food retails enter the UAE by using low-risk entry strategies. Zara was not an exception. It expanded its operations through franchising agreement (Asarpota, 2014).

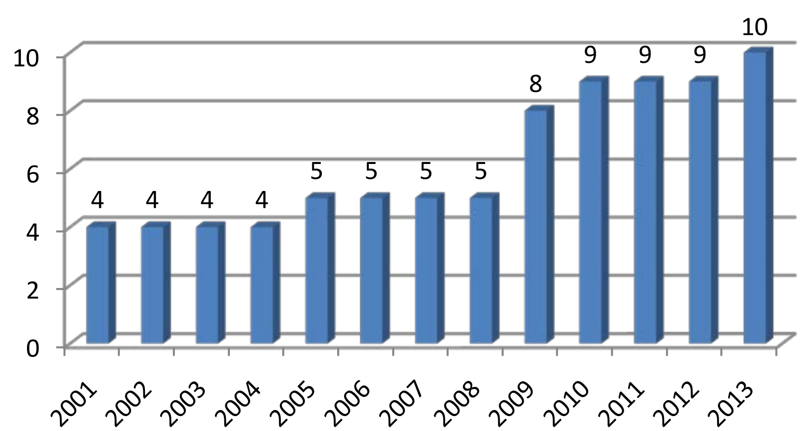

Figure 35- Overview of Zara's stores in UAE (Source: authors' creation based on ARs)

Zara's pace of expansion into UAE has been slow. In 2001, three years after market entry, Zara had only four stores in the country (Annual report, 2001). Currently Zara operates in 10 stores located in the biggest cities of UAE.

In 2006, Zara was chosen as the best fashion chain in the UAE by the major local fashion magazine (Inditex, 2006; Zara the best fashion chain in the United Arab Emirates, 2006) thus underlining foreign brand acceptance in the country.

Saudi Arabia

Zara added Saudi Arabia to its market portfolio in 1999. Saudi Arabia is the largest country in the Middle East with 12th largest demand in the world (Tawil, 2010).

Population of Saudi Arabia is very young. More than 40 % of inhabitants are under 14 years old, 18 % are between 15-24 years. Saudi customers usually are conservative when it comes to clothes. They demand long skirts, long dresses and long sleeved blouses and jeans with embroidery. However, changing customer habits and lifestyles have increase demand for Western style clothing that Saudis wear underneath traditional garb (Ben- Shabat et al., 2009). They have started to require the latest models. Politics and religion also have influence on customer behaviour. Moreover, there is increasing brand awareness among Saudi Arabia customers. Due to hot and humid weather, Saudis are demanding lightweight and bright colors. They prefer natural fabric clothes like light wool, light or medium light cotton. The apparel market in Saudi Arabia is influenced by seasonal trends and religious holidays- during summer, the demand for clothes reaches peak (Tawil, 2010).

Similar to UAE, Saudi Arabia presents several challenges for foreign companies. The market can be entered only in partnership with local retailers (Ben- Shabat et al., 2009). Foreign investment rules of Saudi Arabia require 25% local capital. The government regulates also working hours during religious periods. Usually stores have to be closed or lights should be dimmed during prayer time (Ben- Shabat et al., 2010). Moreover, there are imposed few limits on imports, only direct sales is allowed. Import duties are between 5-10%. Imported goods should have a certificate of origin. It is prohibited to have any kind of prints on clothes that injure prevailing Islamic values. Therefore, foreign companies try to cooperate with local retailers (Tawil, 2010).

Saudi Arabia is considered as a high-risk country with great psychic distance and low sales forecasts. Therefore, Zara entered the market by signing master franchise agreement with Fawaz Al Hakair Group that is the largest retail group in the Middle East (Baena, 2012, Hanieh, 2013). The group has franchise rights on around 60 international apparel brands such Accessorize, Adams Kids, Aldo, La Senza, Marks and Spenser, Massimo Dutti, Vero Moda, etc. (Hanieh, 2013).

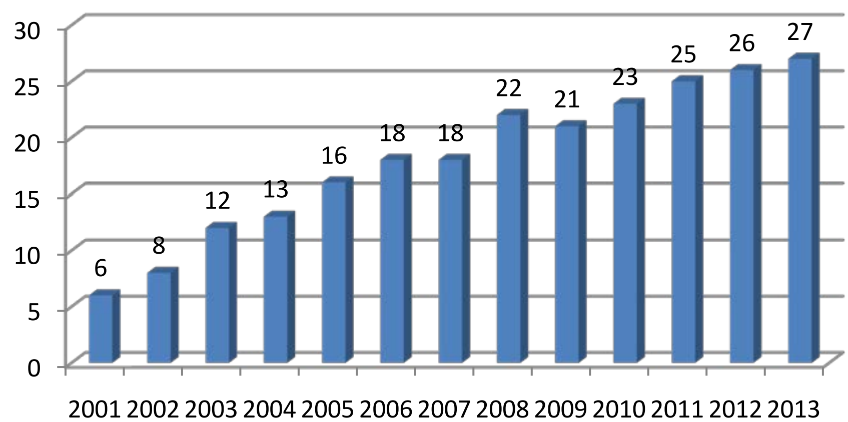

Figure 36- Overview of Zara's stores in Saudi Arabia (Source: authors' creation based on ARs)

Zara has expanded into Saudi Arabia gradually, by opening one or two stores per year. In 2013, Zara had 27 stores in the Saudi market.

Zara's pace of internationalization

In this chapter Zara's pace of internationalization will be analyzed by presenting the time from firm's inception to the first foreign expansion, number of countries it has added to its market portfolio, number of new openings Zara has undertaken over time. In addition, the attention will be paid to markets Zara has entered in terms of psychic distance and how gained knowledge during initial foreign expansion period has affected the speed of further internationalization.

Before first expansion in an international scene, Zara penetrated domestic market. Over the domestic expansion years, by operating in 82 stores (Torun, 2004) the firm acquired knowledge, built capacity, tested its business model and started to establish competitive advantage. It took 13 years from inception of the firm to the first foreign expansion. It shows that initially Zara was established to satisfy local customer needs without vision to expand abroad and become a MNE as it is now.

Zara’s pace of internationalization can be divided into two phases: cautious expansion period (1988-1996) and aggressive expansion period (1998 and onwards).

In period from 1988- 1996 Zara mostly expanded to geographically and/ or psychically close markets such as Portugal (1988), France (1990), Mexico (1992), Greece (1993), Malta (1995) and Cyprus (1996). However, the second foreign market Zara expanded to was both geographically and psychically distant country USA (1989). During the period of cautious expansion, Zara added only one or two countries per year to its market portfolio thus gradually acquiring foreign market knowledge. Until 1998, Zara opened 107 stores overseas and was present in 10 markets (Annual Report, 1998).

Long domestic market penetration period before first expansion abroad and initial expansion to countries with low psychic distance is typical for traditional companies that adopts traditional internationalization pattern by gradually expanding to foreign markets. However, when looking from traditional company perspective expansion to USA is an unusual step due to great psychic distance and insufficient international market experience.

From year 1997, Zara started to expand overseas aggressively. At that time, Zara had already gained valuable experience in international environment. Therefore, further expansion was performed more rapidly by entering markets that are more distant and opening a larger number of stores (see figure below).

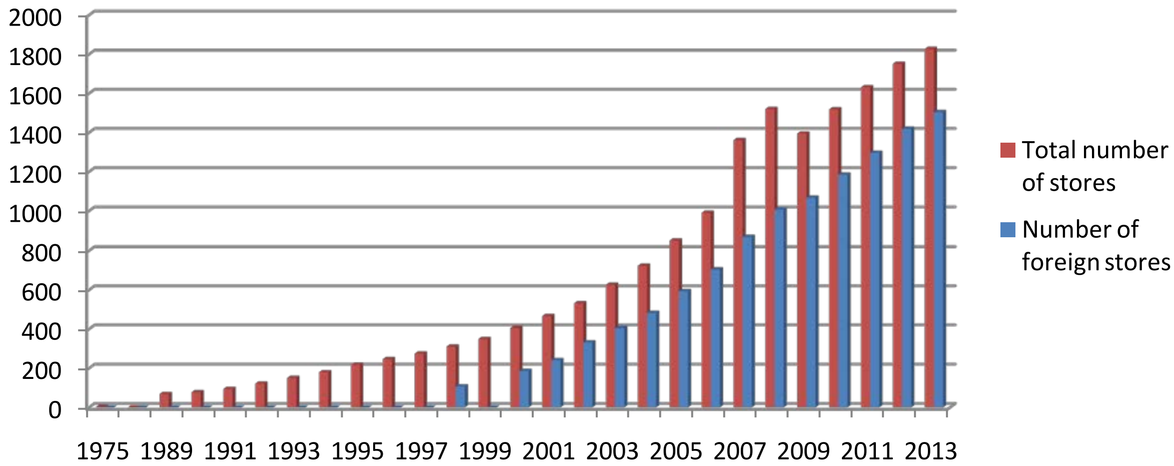

Figure 37 - Overview of Zara's stores (Source: authors' creation based on ARs)

Zara started the aggressive expansion period by opening its first store in a distant market Israel in 1997. Afterwards, in 1998, Zara opened stores in eight countries in Middle East (Kuwait, Lebanon, the United Arab Emirates), Americas region (Argentina and Venezuela), Asia (Japan) and Europe (the UK and Turkey). In 1999, rapid expansion continued with adding nine countries to Zara's market portfolio (see figures in appendix A). However, in 2000 the pace of internationalization slowed down as Zara opened its stores only in four new markets.

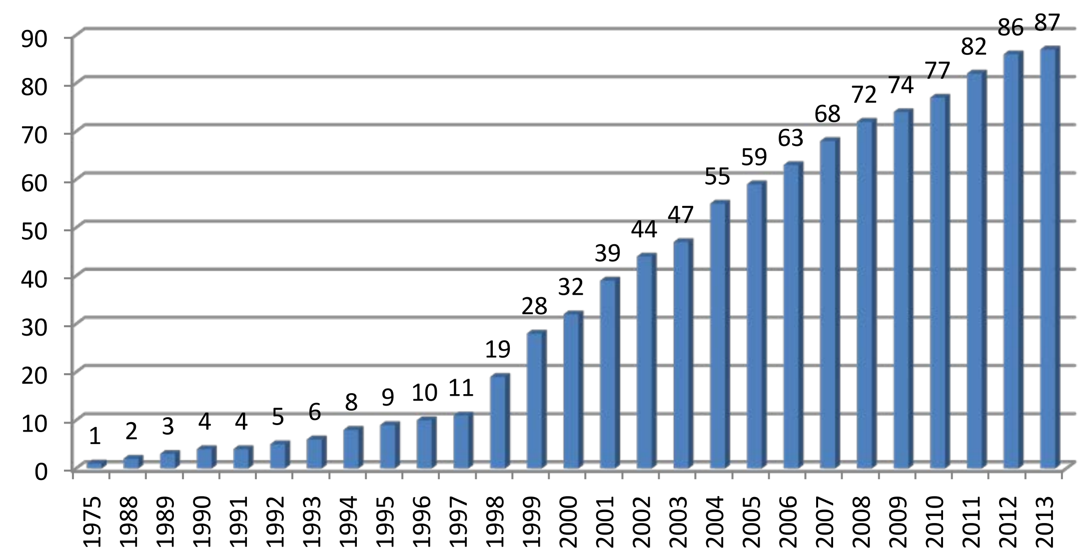

Figure 38- Overview of countries with Zara stores (Source: authors' creation based on ARs)

The aggressive expansion period have a cyclic character. Years of aggressive expansion into 7-9 new markets followed by slower expansion periods when Zara entered 3-4 countries per year (see figure). However, when observing the number of opened foreign stores, rapid expansion can be noticed over the whole period of investigation (see figure above). In 2001, Zara opened 55 stores overseas. Afterwards, the number of new openings increased. The largest number of new store openings can be observed in 2007 and 2008 when Zara opened 166 and 136 foreign shops respectively. In 2007, the sales from Zara's international stores constituted 77 % of total revenues (Annual report, 2007). In May 2015, Zara had 2088 stores in 88 countries (International presence).

The aggressive expansion period does not correspond with tradition company international expansion model. Zara's expansion during this period was not gradual as developers of the stage model suggest. Zara was entering different continents and increasing its presence in psychically distant markets at the same time. Therefore, this expansion period is relatively chaotic in terms of market diversity and more corresponds with pace of internationalization adopted by born global companies that seeks to gain competitive advantage by expanding all over the world.

Zara's main competitors

In order to realize how facing with several strongest competitors affected Zara's internationalization process, the competitors' overview will be provided. In addition, the purpose of following chapter is to understand what the main aspects in Zara's business model are which ensured global leader position. Moreover, the overview aim is to point out at some functions and elements competitors are using, which also can increase attractiveness of the company.

On different regions and markets within, Zara is facing many competitors. In term of size, tradition and business scope, three of them are very strong: H&M, Benetton and Gap.

Zara vs. H&M

Hennes and Mauritz (H&M) is the Swedish fashion retailer, established more than 65 years ago. The main concept of the company is to offer merged quality and fashion at the best price.

Nowadays, H&M is the highest valued fashion brand in Europe; with a brand value around 13 billion Euros (The H&M Group). Under the H&M brand six independent brands are incorporated, currently present in 57 markets all over the world and via online shopping in more than 20 countries.

Although, Zara and H&M are very similar in term of their engagement in fast fashion industry and two largest fashion retailers in Europe, their business strategies have many differences. While Zara based competitive advantage on the efficient and ongoing communication with customers and subsequently responding faster on customers demand through continuous communication with market, in H&M yearly offer is based on two main collections.

Those long-lead items are two seasons' collections: spring and fall, supported with a few sub-collections each season (Yeung, 2013). Furthermore, following the principles of constantly updating the assortment, Zara forces customer to come more often to see new offers.

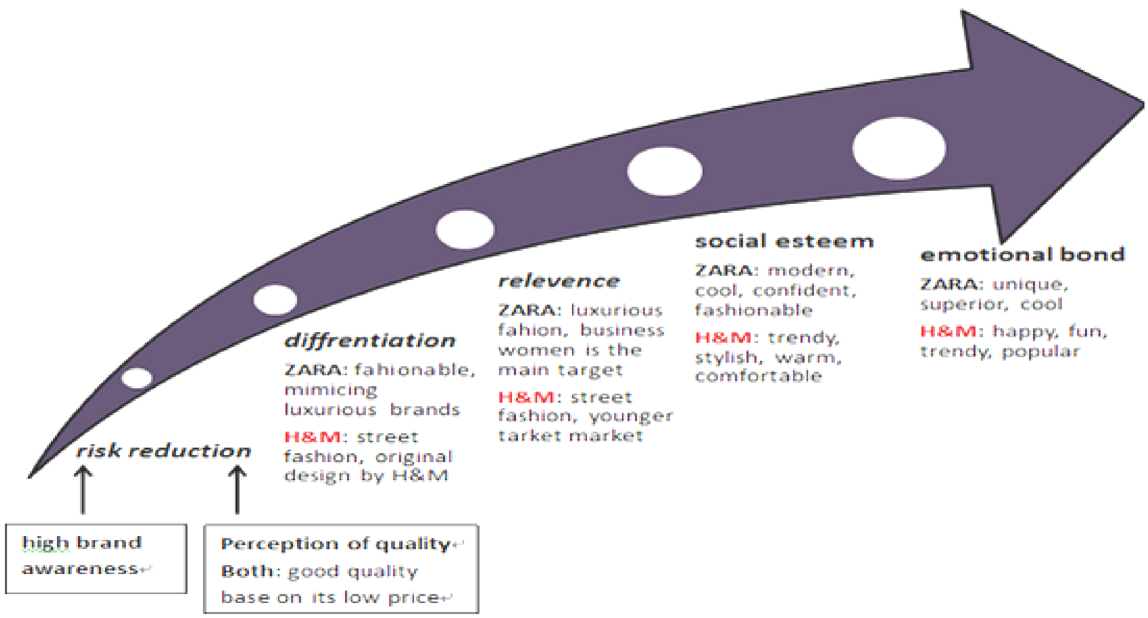

Figure 39- Zara vs. H&M (Source: Yeung, 2013)

Another significant difference between Zara and H&M regarding their offer is in their focus. Zara is known by replicating more luxurious brands and offering them on affordable prices. The focus is on catwalk inspired products, seen on fashion shows. Therefore, part of their strategy is sending designers on fashion events and scanning the newest designs. In H&M focus is on street fashion and everyday clothes. However, H&M occasionally hires the famous designers to design some original clothes (Smith, 2014a).

In addition, the way companies are communicating their brand is slightly different. As mentioned, H&M often engage designers to create the product or collaborate with celebrities to advertise it. Zara's advertisement strategy is divergent. From Inditex's total revenue only 0.3% is costs of advertising. This is primarily due to the fact that Zara is not advertising on billboards or TV, as focus is more on shop windows and simply meeting the customers' needs (No Advertisements Strategies).

Zara vs. Benetton

United Colors of Benetton (Benetton afterwards) is Italian global fashion brand which is consisted from two independent brands: Benetton and Sisley. The company was established in 1965, by Benetton family were actually name comes from (Benetton- history). Nowadays, it is worldwide expanded brand with franchise in 120 countries. Furthermore, in 1991 Benetton launched an international magazine, which is promoting Benetton's clothes and multicultural environment (United Colors of Benetton).

As one of the biggest strategic difference in Zara and Benetton performing is satisfying the customers' needs. While Zara focuses on fast replication and more aggressive changes in assortment, Benetton manufactures two main collections per year, which do not meet effectively customers' preferences. In addition, the main inspiration for Benetton models starts with research. It is well known fact Benetton sends its designers to search for inspiration, new trends and ideas all over the world. As previously mentioned, Zara's main inspiration comes from fashion shows and glamorous brands.

With regard to advertising and communication strategy, the one used by Benetton is highly advanced and expensive comparing with Zara's. The communication strategy of Benetton is established with an aim to express company's concern on global level. By applying this strategy Benetton focused on international campaigns which are presented by unique themes through comprising current offer, homogenous message and actual time. Furthermore, in order to promote multicultural, colorful and global company image, Benetton often faced extremely high advertising expenditures (Palladino, 2010).

Perhaps the biggest Zara’s advantage over the Benetton is in strong vertically integrated business model. This means that Zara possesses total control off all activities such as: designing, manufacturing, logistics and distribution to the store. In Benetton, vertical strategy was replaced with retail strategy which is heavily relying on franchisees. Subsequently, Benetton introduced operation strategy focused on speed in terms of placing the assortment to the market and quality. Zara is manufacturing around 60% of its own products and around quarter of production has been placed in Spain (In Europe around 50%). In recent years, only 10% of Benetton products are manufactured in Italy. The rest is split between Eastern European countries, Asia and Africa (Tunis). This decision is resulted with flexibility, lower labor costs and availability of skilled labor (Which of the Three Supply Chain Strategies is The Most Competitive Business Essay, 2013).

The same as Zara, Benetton gains the largest sales share from Europe, hence particularly Western European countries are considered as home market. However, Zara is not focusing on advertising like Benetton does, as the target is satisfying customers’ preferences. Zara’s international strategy is based on combined product differentiation and costs leadership. In Benetton’s case, the strategy is more focused on product differentiation as prices are higher than competitors and targeting the upper classes (Which of the Three Supply Chain Strategies is The Most Competitive Business Essay, 2013).

Zara vs. Gap

One of the Zara’s main competitors is Gap Inc., the biggest US specialty-apparel retailer. Founded in 1969, Gap is well-known multinational clothing and accessories retailer. The brand Gap possesses six apparel brands: Gap, Banana Republic, Old Navy, Athleta, Piperlime and Intermix (Gap about brands).

Recently, Gap is facing difficult times, where only Banana Republic brand is performing well. Particularly on European markets Gap is struggling with strong competition, which resulted to decision to dismantle European designers’ team and transfer it to the US (Amed, 2008). The company is present internationally, focusing on large markets in developed countries. Nowadays, Gap has around 3050 stores in following countries: France, the UK, Japan, United States and Canada. The strategy of focusing on those markets can be explained through company's focus on young and urban population, with preferences for quality and more expensive clothes. However, in recent period company is struggling to attract younger buyers to its stores.

This was resulted with change in customers' choices and US economic slowdown, which additionally affected customers' purchase power (Keeley and Clark, 2008).

The company is present in different regions: Europe, US and Asia. However, in mentioned regions focus is only on high developed markets. Therefore, it can be concluded that Gap's internationalization process was cautious, as company was present at home market only, for a long time after establishing.

In addition, first internationalization adventures were in countries very similar in terms of cultural aspects and customers' preferences: Canada and the UK. Subsequently, Gap penetrated in France and Japan. From that point, Gap and Zara are very similar, as Zara started internationalization after 13 years, in countries very similar to home market. Although, Zara has period of aggressive expansion, what is not the case of Gap, as company operates in several countries only. In Gap strong focus is on home market.

Gap Inc is outsourcing its production and possesses partial vertical integration. The company is controlling design, sales and distribution functions. This is also different than in Zara, where focus is on strong vertical integration and ownership over all functions. All Gap's stores are 100% ownership of the company. This is feasible as company operates in developed markets, with minimized risks and barriers for property acquisition.

Another significant difference between Gap and Zara are advertising activities. While Gap is devoting almost 4% of revenue to advertising activities, for Zara as previously mentioned, store is main tool for communication with customers (Lopez & Fan, 2009).

Based on the presented overview and analysis of Zara and main competitors, it can be concluded that companies in fashion industry are applying diverse business models. For instance, while

Zara is focused on strong vertical integration and possessing high degree control over the functions, Gap and H&M are conducting partial vertical integration with focus on several functions and outsourcing the production. Furthermore, Zara's internationalization expansion is wider than competitors', owing to company's strategic decisions and subsequently faster adjustment to customers' demands and existing trends. In Gap the focus is on highly developed markets and, therefore, international presence is very narrow. Again in comparison with competitors, Zara's business strategy does not contain strong advertising function, as negligible percentage of revenue is spending on it; yet, company has a strong communication with customers through the stores. As opposed to that, Benetton is focused on expensive advertising campaigns, promoting not just the fashion offer but company's concerns about some main issues in the world.

DISCUSSION

The main objective of the dissertation is to reveal internationalization patterns of Zara by explaining the motives behind Zara's market selections, factors influencing choices of entry strategies and analyzing the pace of foreign expansion.

After reviewing literature on internationalization of MNEs the conceptual framework was developed. Internationalization scope and pace as well as entry strategies were chosen as the key elements characterizing internationalization patterns of Zara. Further two groups of factors determining the internationalization patterns were distinguished: firm's specific factors and host market advantages. For further research following factors were selected: market experience, firm's specific advantages and strategic objectives, psychic distance, foreign market attractiveness, business and institutional conditions in the host country. Results from analysis part have been summarized in the appendix B.

The internationalization process of Zara can be divided into two phases: cautious and aggressive expansion. Zara started foreign expansion only 13 years after establishment, thus initially acquiring business knowledge by operating in domestic market. Zara started its international journey by entering neighbor country Portugal that is similar to Zara's home market in terms of customer needs and psychic distance. Besides Portugal, during the cautious expansion phase (1989-1996), Zara entered mostly geographically and psychically close markets like France, Greece, Belgium, Sweden, Malta and Cyprus. Most of these markets were members of EU. That facilitated Zara's expansion to European region due to similarity of legal regulations. Zara expanded to France despite tough competition in the market. Entering France was a strategic decision. France was used as a step stone for expansion to other European countries. Zara entered also the Mexican market, that is considered to be psychically proximate market and provided a reference to the rest of Americas region. However, during the cautious expansion stage without having significant international market experience Zara entered USA, geographically and culturally distant market. It was an unusual choice. According to the Uppsala model, firms acquire international market knowledge in proximate markets. Then firms are gradually moving from proximate markets to regions that are more distant. Expansion to USA was a strategic decision. In order to increase brand awareness and become global brand, Zara had to be present in New York, one of the fashion capitals. Moreover, by entering USA Zara was closer to the newest fashion trends and could learn from American competitor Gap. During the cautious stage of foreign expansion Zara expanded gradually by entering one or two countries per year.

During the aggressive expansion phase (1997 and onwards), Zara internationalized more rapidly by adding up to nine countries to its market portfolio per year. Zara's international journey took place in different markets regardless psychical and geographically distance. During first two years (1997 and 1998), it consolidated its presence in Middle East by entering Israel in 1997 and one year later expanding to Kuwait, Lebanon and the United Arab Emirates. It seems that Israel has been used as a springboard for further expansion to Middle East despite there cannot been found data supporting this assumption in the secondary literature sources. Middle East markets are attractive due to growing population, increasing spending per capita and growing demand for global brands. In 1998, Zara started to expand to Asia (Japan) and entered some European countries (Turkey and the UK). Further international expansion took place also in Americas region. By acquiring initial international market experience and opening stores in Americas region and Europe, Zara was ready to expand more rapidly to more distant markets at the same time. At this stage Zara's goal was to increase its presence all over the world, thus becoming a global brand. Thus it can be inferred, that the Zara's pace of internationalization during the aggressive expansion period corresponds to patterns adopted by born global companies.

There cannot be noticed specific pattern of factors that determined Zara's market choice. During the cautious expansion phase, Zara focused mostly on expansion to psychically proximate markets. Afterwards, by increasing international market knowledge it started to expand more rapidly by entering several distant markets at a short period of time. Usually Zara chose one country as a springboard for further expansion in the region and then by acquiring initial market knowledge continued penetrate a particular region. For instance, Zara entered South America by opening its first store in Argentina, country with high per capita spend in apparel and low entry barriers. Afterwards, it continued expansion to the region by entering Venezuela, Brazil, Chile and other markets later on. Zara was entering different markets in terms of market size and growth potential, psychic distance, business and institutional conditions. Only different market strategies have been applied in different markets.

Zara has chosen different entry strategies: wholly owned subsidiaries, joint venture and franchising. Wholly own subsidiaries mostly were used to enter several European countries and penetrate the Americas region. Both regions were considered to be less risky and showed a great growth potential. Moreover, Zara considered the European markets as a home market. The enlargement of the European Union facilitated Zara's penetration in the region by removing entry barriers and aligning legal policies. Despite geographic and psychic distance, Zara established own stores in the most of countries in the Americas region. This region also had a growth potential and were perceived to have quite low business risk. Moreover, it can be noticed that at the initial stage of foreign expansion Zara preferred to establish wholly owned stores when entering new markets thus having full control over foreign operations.

Joint venture was used in markets were Zara faced some entry barriers or lack the knowledge regarding the market. In Germany and Japan Zara faced with difficulties to acquire properties. It was easier and quicker to enter Italy with local partner due to administrative barriers. Due to legal restrictions regarding FDI, Zara had to apply joint venture when expanding to India. Because of different obstacles and unfamiliarity with market, Zara established joint venture also in South Korea.

Franchising concept has been used mostly in less significant markets or markets with low growth potential or high business risk. For instance, in the European countries like Baltic countries that are characterized with small population franchising has been adopted. Psychically distant and high- risky countries like Saudi Arabia, UAE, Israel Zara has entered by signing franchising agreements. Moreover, this entry strategy has been used in the Middle East countries in order to overcome liability of foreignness in terms of psychic distance and entry barriers.

According to Uppsala model, in order to overcome liability of foreignness and acquire some market knowledge it is suggestible to choose non-equity entry modes in the initial stage of internationalization and gradually increase control in the host market by engaging in FDI later. However, Zara started its international journey by opening wholly owned stores in the most of the markets it entered during the cautious internationalization stage. Only in Malta and Cyprus, countries that are not so significant in terms of market size, franchising as entry strategy was chosen. Afterwards, only in markets that demonstrated barriers for FDI or other challenges with regard to distribution and acquisition of premises Zara entered by establishing joint venture. Markets with low growth potential, high- business risk in combination with psychic distance Zara expanded by entering in franchising agreements. According to Uppsala, Zara should have to start with low- risk entry modes despite market attractiveness and psychic distance. The stage model determines that a firm has to gradually strengthen its presence in a market by changing entry modes over the time to ones that increases firm's commitment in a particular market. This shows that Zara's internationalization patterns cannot been described with a help of Uppsala model.

According to Dunning, firm should engage into FDI when there are present all three types of advantages: ownership advantages, location advantages and internalizing advantages. In Zara's case we can see that the firm has strong ownership advantages that facilitate foreign expansion. Host markets advantages (location advantages) not always can be noticed. However, also in markets that do not possess strong location advantages equity entry modes have been applied. Zara wanted to have a full control in the most significant markets in order to maintain its competitive advantage that lies in fast production and frequent store replenishment. Moreover, in order to get customer feedback it was essential to get gathered data from stores on daily basis. Therefore, Zara used FDI to gain competitive advantage by internalizing foreign operations (realizing internalization advantages). This means that the business model of Zara might have some implications on the choice of entry strategies.

However, Zara's choice of entry strategies contradicts to the TCE theory, that state that the less costly entry mode needs to be applied. When looking at Zara's case, sales of clothes does not mandatory require asset specificity investments, sales might just as well be performed via external partner. Therefore, it would be cheaper to enter markets by signing franchising agreements, especially in psychically close markets where behavioral uncertainty is low. According to the TCE wholly owned subsidiaries should be established in more distant markets, where uncertainty is high, in order to overcome behavior uncertainty. However, when analyzing Zara's case it can be noticed that its foreign expansion has been performed contrary to the TCE theory. Full equity modes Zara used in markets that possess lower behavior uncertainty (like most of European countries). Nevertheless, in markets with high uncertainty Zara was entering by establishing joint venture (for instance, India, Japan, South Korea) or signing franchising agreement (Middle East countries).

In the dissertation, internationalization patterns of Zara have been examined by focusing on analysis of motives behind market selection, entry strategy choice and pace of foreign expansion. The discussion provided above shows that none of existing international business theories accurately describe internationalization patterns of Zara. Therefore, in future the focus of research should be put on new internationalization model creation.

The main drawback of the research lies in a fact that it is a single case study that limits the validity of the study and does not allow providing generalizations. Another limitation comes from the secondary nature of the information used to carry out the study. Several sources have been used to validate the credibility of data and minimize the research bias. However, the study has explanatory character and presents authors' reflection on Zara's internationalization patterns. The dissertation might provide a good insight into internationalization process of MNEs and might give an incentive for future studies.

LIMITATIONS

In order to provide with high degree of reliability and quality of dissertation, we have to admit some limiting factors faced while accomplishing it. The greatest limitation we experienced was regarding data collection. As the dissertation is based on secondary data only, there is a risk of its subjectivity, as used references are interpreted by other authors, and could have an impact on the dissertation. In addition, lack of company's primary data created some obstacles in answering the research questions. Understanding the company's motives for market selections, as well as factors for entry mode choice would be easier if focal company's sources could be used and primary data reached. The same goes for analysis of internationalization pace during various periods in expansion.

As mentioned, we built our research on secondary data, heavily relying on company's annual reports. Nevertheless, we experienced some limitations regarding expected data. Most of annual reports were lacking clear statement regarding mission, vision and strategy, and were mainly focused on corporate social responsibility integrated into the company's business model. In addition, different market data were meagerly, which required additional time in order to collect relevant and valid data needed for analysis.

Lastly, aiming to provide with extensive research and understandable internationalization process, we created conceptual framework consisted from three crucial elements: scope, pace and entry modes. However, while providing the theoretical overview as basis for future analysis, we realized that one of them: pace, is under researched, as small numbers of scholars have investigated it.

Yet, it did not affect our goal to include all elements as their mutual analysis could provide better understanding of problem statement and internationalization expansion of the company in focus.

CONCLUSION

The main goal of the dissertation was understanding the internationalization patterns used by companies in fashion industry through analysis the internationalization process of particular company: *Zara*. In order to be able to cope with underlined problem statement, we aimed to answer on several research questions this research was supported with. The analysis part is focused on three main regions and answering on research questions was based on information we gathered from company's annual reports, publications and various articles.

The first research question: what are motives behind Zara's market selections?

Based on accomplished analysis, there are several motives Zara aimed to achieve through international expansion in different regions. On European markets, company focused on penetrating in developed countries, with built fashion history and strong existing demand. The company wanted to be close to customers with solid bargaining power which preferences are already known. Aiming to expand into US markets, Zara achieved the status of truly transnational retailer. In addition, by entering in such a huge region, company tried not just to reach large population markets, but to bring the breath of traditional European fashion. Moreover, introducing with this large distance region brought huge market experience to the company. On Asian and Middle East regions, Zara gained economies of scale, due to the low labor costs and size of markets. Furthermore, on this region Zara was motivated with increasing purchasing power of buyers, low suppliers costs and a huge potential of online sales.

The second research question: what factors have influenced Zara's entry mode choice?

Several different factors determined the company's entry mode choice. As mentioned in analysis part, the main entry modes company used are: wholly owned stores/subsidiaries, franchising and joint venture. In strong and developed markets, with great potential Zara preferred opening of the own stores. Those markets Zara found in most of European countries, in some developed South America's markets such as Chile and Argentina, and from all Asian markets: only in China, due to foreign investment reliefs and large potential market. In spite of the potential some large and developed markets might possess, Zara decided to enter those through establishing the joint venture partnership with local company. The main reasons were existing obstacles in getting the property right, strong present competition or barriers built by host country government. Zara faced those barriers entering Japan, India and two European markets: Italy and Germany. In some markets, Zara perceived different types of risk, such as transition period in market development or existing political and social establishment and therefore, decided to apply less risky entry mode strategy: franchising. This entry mode type was primarily used for Middle East countries and some recent European Union members from Baltic and South East European countries. In addition, this type of operational mode company applied in small markets.

The third research question: what is the pace of Zara's foreign expansion?

Having in mind all Zara's selected markets and used entry strategies, it must be emphasized that the company expanded on those in a different pace. After brief company's internationalization analysis, it can be concluded that two main period distinguished on the international scene. Before decisions about foreign expansion, company was growing primarily on home market until it reached the saturation point and decided to go abroad. The first international period was marked with cautious internationalization, where the company mostly focused on close distance markets with minimum risk and possibility to gain relevant market knowledge. The second phase was characterized with aggressive expansion, where company was successfully penetrating in several markets in different regions at the same time. This phase came the latest, after Zara was able to deal with different market challenges, based on gathered knowledge and experience.

Finally, we claim that numerous factors and motives determined Zara's internationalization patterns. Furthermore, the company's internationalization process is complex and time consuming set of analysis and decisions that requires deep insight in all relevant factors. Those however include specific characteristics company might possess as well as host country location advantages.

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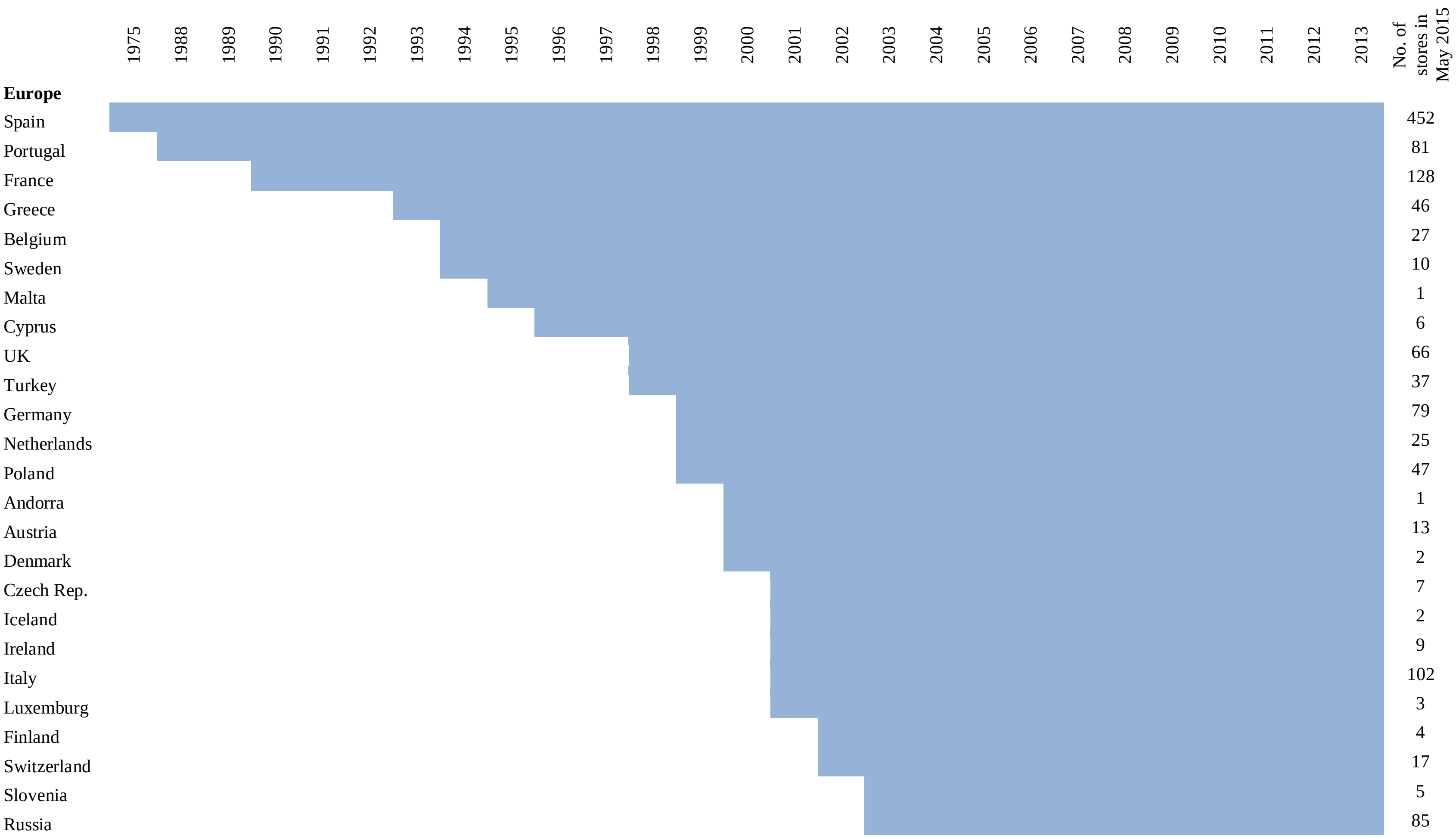
APPENDICES

Appendix A- International presence of Zara

Zara in Europe



Zara in Europe- continued

	1975	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	No. of stores in May 2015
Estonia																												
Latvia																												
Romania																												21
Hungary																												8
Lithuania																												4
Monaco																												1
Serbia																												4
Norway																												3
Croatia																												9
Slovakia																												3
Montenegro																												1
Ukraine																												9
Bulgaria																												6
Azerbaijan																												2
Armenia																												2
Bosnia																												2
Macedonia																												1
Georgia																												2
Albania																												1
Subtotal																												1340
No. of countries	1	2	2	3	3	3	4	6	7	8	8	10	13	16	21	23	25	30	31	33	35	37	37	38	39	43	43	44

Source: Adapted from Lopez et al., 2009, updated with data from Annual Reports and International presence

Zara in Americas region

	1975	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	No. of stores in May 2015
Americas																												
USA																												53
Mexico																												64
Argentina																												10
Venezuela																												10
Canada																												26
Chile																												9
Brazil																												53
Uruguay																												2
Puerto Rico																												2
El Salvador																												2
Dominican Rep.																												2
Panama																												2
Costa Rica																												2
Colombia																												11
Guatemala																												2
Honduras																												2
Peru																												2
Ecuador																												2
Subtotal																												256
Number of countries			1	1	1	2	2	2	2	2	2	4	8	8	9	11	11	12	13	13	15	16	16	16	17	18	18	18

Source: Adapted from Lopez et al., 2009, updated with data from Annual Reports and International presence

Zara in Asia and ROW

Asia and ROW	
Israel	23
Japan	95
Lebanon	7
Kuwait	6
United Arab Emirates	11
Saudi Arabia	28
Bahrain	2
Qatar	2
Jordan	2
Singapore	8
Malaysia	9
China	165
Morocco	4
Indonesia	13
Philippines	8
Thailand	9
Tunisia	2
Oman	1
South Korea	43
Egypt	5
Syria	0
India	15
Kazakhstan	4
Australia	13
Taiwan	7
South Africa	6
Algeria	1
Subtotal	960

Number of countries											1	5	7	8	9	10	11	13	15	17	18	19	21	23	26	25	26	14
Total number of countries	1	2	3	4	4	5	6	8	9	10	11	19	28	32	39	44	47	55	59	63	68	72	74	77	82	86	87	88

Source: Adapted from Lopez et al., 2009, updated with data from Annual Reports and International presence

Appendix B- Overview of factors influencing Zara's internationalization patterns

	Entry mode	Year of entry	Market experience	Firm's specific advantages	Strategic objectives	Psychic distance	Market attractiveness	Industry and competitive structure	Business conditions	Institutional environment
Europe										
Portugal	WHS	1988	Home market only. No previous international experience.	Production facility, low cost labor		Low distance	Attractive market, existing demand	No direct competitor		Familiar. Under the same EU regulatives
France	WHS	1990			Large population. Step stone for further expansion	Low distance		Developed industry. Strong competition		Familiar. Under the same EU regulatives
The UK	WHS	1998					Market growth potential			Familiar. Under the same EU regulatives
Germany	JV-WHS	1999			Meeting customer needs. Link to the North Europe an markets		Market growth potential	Strong international competition	Challenging. Established JV; subsequently WHS	Familiar. Under the same EU regulatives
Italy	JV-WHS	2001	Beginning of aggressive expansion. Wide international experience			Low distance		Developed industry. Strong competition	Challenging. Established JV; subsequently WHS	Familiar. Under the same EU regulatives

	Entry mode	Year of entry	Market experience	Firm's specific advantages	Strategic objectives	Psychic distance	Market attractiveness	Industry and competitive structure	Business conditions	Institutional environment
Americas										
USA	WHS	1989	Considering the size of market, no relevant previous market experience. Huge experience gained through the penetration		NY- one of the fashion capitals: presence in one of the major international markets	Different customer needs	Big market	Tough competition		
Canada	JV (95%)-> WHS (2002)	1999				Great distance	Big market			
Mexico	JV	1992			Step stone for expansion to South America	Low distance	Big market			
Brazil	WHS	1999				Different seasonality	Big market; lack of reliable suppliers		Taxation, logistics	Bureaucracy
Argentina	WHS	1998			Step stone for further expansion to South America	Similar customer needs; different seasonality	High people concentration in urban areas, high per capita spend in apparel			Opened for FDI

	Entry mode	Year of entry	Market experience	Firm's specific advantages	Strategic objectives	Psychic distance	Market attractiveness	Industry and competitive structure	Business conditions	Institutional environment
Americas (continued)										
Venezuela	WHS -> F (2002)	1998				Different seasonality			Fair Price law; import restrictions	Frequent changes in government policies, growing aversion to Spanish firms
Columbia	F	2007				Conservative, reluctant customers	30 cities with population over 20.000; big apparel retailing market		Fluctuating currency exchange rates, heavy taxes, costly logistics; established distribution channels	Costly legal system, and political instability
Chile	WHS	1999				Conservative customers; different seasonality				

	Entry mode	Year of entry	Market experience	Firm's specific advantages	Strategic objectives	Psychic distance	Market attractiveness	Industry and competitive structure	Business conditions	Institutional environment
Asia and ROW										
China	WHS	2006	Sufficient international market experience		Economy of scale, cheap suppliers		Big market, cheap labor (suppliers), potential for online sales	Tough competition	Open for foreign investments, low barriers	
India	JV (51%)	2010			To penetrate in one of the biggest world markets, with increasing purchasing power	Different customer needs, great psychic distance, no seasonality				Legal restrictions for FDI (only partnership with local firm is allowed) and property acquiring
Japan	JV	1998		The significant advantage company possesses is due to Japanese perception of Western concept and way of living.			Demanding market and large target	Strong competition		Limitations on store size, expensive real estate
South Korea	JV (80%)	2008				Great psychic distance		Strong competition		
Israel	F	1997			Presence in highly populated Middle East region	Different customer needs, great psychic distance	Small market, demand for foreign brands			Risky market due to the problems between Israelis and Palestinians

	Entry mode	Year of entry	Market experience	Firm's specific advantages	Strategic objectives	Psychic distance	Market attractiveness	Industry and competitive structure	Business conditions	Institutional environment
Asia and ROW continued										
UAE	F	1998					Attractive market due to high concentration of population in urban areas and one of the highest consumer spending per capita			Legal restrictions for FDI (only partnership with local firm is allowed)
Saudi Arabia	F	1999				Conservative customers; different demand in terms of textile, great psychic distance	Big market with young population, low sales forecasts			Legal restrictions for FDI (only partnership with local firm is allowed)

favorable conditions
acceptable conditions
unfavorable conditions