SERVICES

Zara's hometown upskills to cater to high-end workers

After avoiding the worst of a recession, A Coruna flourishes, thanks to demand for top amenities

Bloomberg

The hipsters of Inditex gave Miguel Lamas a helping hand when he opened his barbershop in A Coruna, on the northwestern tip of Spain, at the height of the financial crisis in 2012.

Inditex, the world's biggest clothing retailer – best known for its Zara brand – lured hundreds of high-end workers from around the globe to the port city in the province of Galicia, transforming the area into a hub for the arbiters of street trends and helping it through the recession. With the one-time sleepy, rain-swept region turning into a fashion powerhouse, people like Lamas are flourishing.

"Our customers are usually medium- to upper-class, who invest in their beards and follow the latest trends, and Inditex people set those trends," said Lamas, whose Hermin's Beauty Salon & Barber Shop sits on a cobbled street in the town centre.

Inditex was founded by Amancio Ortega, now the world's fifth-richest person, who moved to A Coruna with his family as a teenager. The company, which opened the first Zara store in the city in 1975, now has annual revenue of more than €20 billion (HK$194 billion).

Inditex's market value has soared to €78 billion from about €9.3 billion at its 2001 initial public offering. It has given Ortega, 81, a personal fortune of €68 billion. And while concern that the company will signal cooling sales when it reports results on March 14 pulled shares down to a three-year low recently, Inditex is bolstering its online business to beat rivals and meet the rising pressure of Amazon.

For the region around A Coruna, Inditex's continued success is crucial. About 4,600 of its 162,400 employees worldwide are at its headquarters in Arteixo, about 13km from A Coruna. Thanks to the apparel giant, the region no longer needs to do what it has traditionally done: export its sons and daughters to the Americas in times of economic hardship.

It has helped that Inditex employees are big spenders, with a lifestyle that has spawned a secondary economy of its own.

"Inditex staff have high salaries," said Felix Blazquez, head of the University of Coruna's business studies department. "They look for high-standard leisure and services and the city has changed to offer what they demand."

Inditex workers with money to spend helped persuade Cesar Perez and Luis Jarque in 2012 to open La Urbana, a modern bar with a no-frills design, undeterred by the financial crisis.

"It soon became known as the Inditex bar – many of their employees came to have a drink here," Perez said. "The crisis in A Coruna didn't hit as hard [here], and that's because of Inditex."

The company's growth was a bright spot as Spain grappled with a real estate crash and financial crisis that caused the economy to shrink by almost 10 per cent between 2009 and 2013. At the height of the crisis in 2012, while the Galician economy tanked 3.2 per cent, Inditex shares soared 67 per cent as global revenue jumped 10 per cent.

A significant amount of Inditex's production takes place in Galicia. The retailer also has one of its main redistribution centres in the city, which means clothes are sent there from factories in different countries and then redistributed to stores globally.

A Coruna, with a population of 244,000, ranks No 18 in size among Spanish cities. Still, the city and its province exported goods worth €10.1 billion in the first 10 months of last year, or about 4 per cent of Spain's total, according to Economy Ministry data. That was more than any other Spanish region with the exception of Madrid, Barcelona and Valencia, the country's three biggest cities. A Coruna's trade surplus of €3.8 billion is the highest of any Spanish province.

"They export 24 hours, 365 days of the year – it's unbelievable," said Gonzalo Ortiz, general director of A Coruna's chamber of commerce, whose job includes certifying the origin of goods from the city's companies.

> The [financial] crisis didn't hit as hard [here], and that's because of Inditex
>
> CESAR PEREZ, OWNER, LA URBANA BAR

The influence the company wields means that much of the city's economic activity revolves around the wealth generated in Arteixo. That may not be entirely healthy, the University of Coruna's Blazquez said.

"The problem now is that many of them rely exclusively on Inditex, and they would be in trouble if that collaboration were to end," he said.

For now, moving away does not seem to be part of Ortega's plans, Xulio Ferreiro, the city's mayor, said in an interview. In the last 15 years, the foundation named after the Inditex founder has donated about €80 million for charitable projects in Galicia, including the construction of the headquarters of a charity caring for homeless people and the elderly.

And while the changes in the retail landscape may change Inditex's fortunes in the longer term, for now people like Lamas are riding the Zara wave.

His barbershop in downtown A Coruna charges €30 for a haircut, a price made possible by demand for the latest styles from the Inditex crowd. Beer is served from a bar adjoining the salon.

"This business wouldn't be possible without Inditex," Lamas said.

Inditex has grown into a €78 billion business since it opened the first Zara store in A Coruna in 1975. Photo: Bloomberg

INVESTMENT

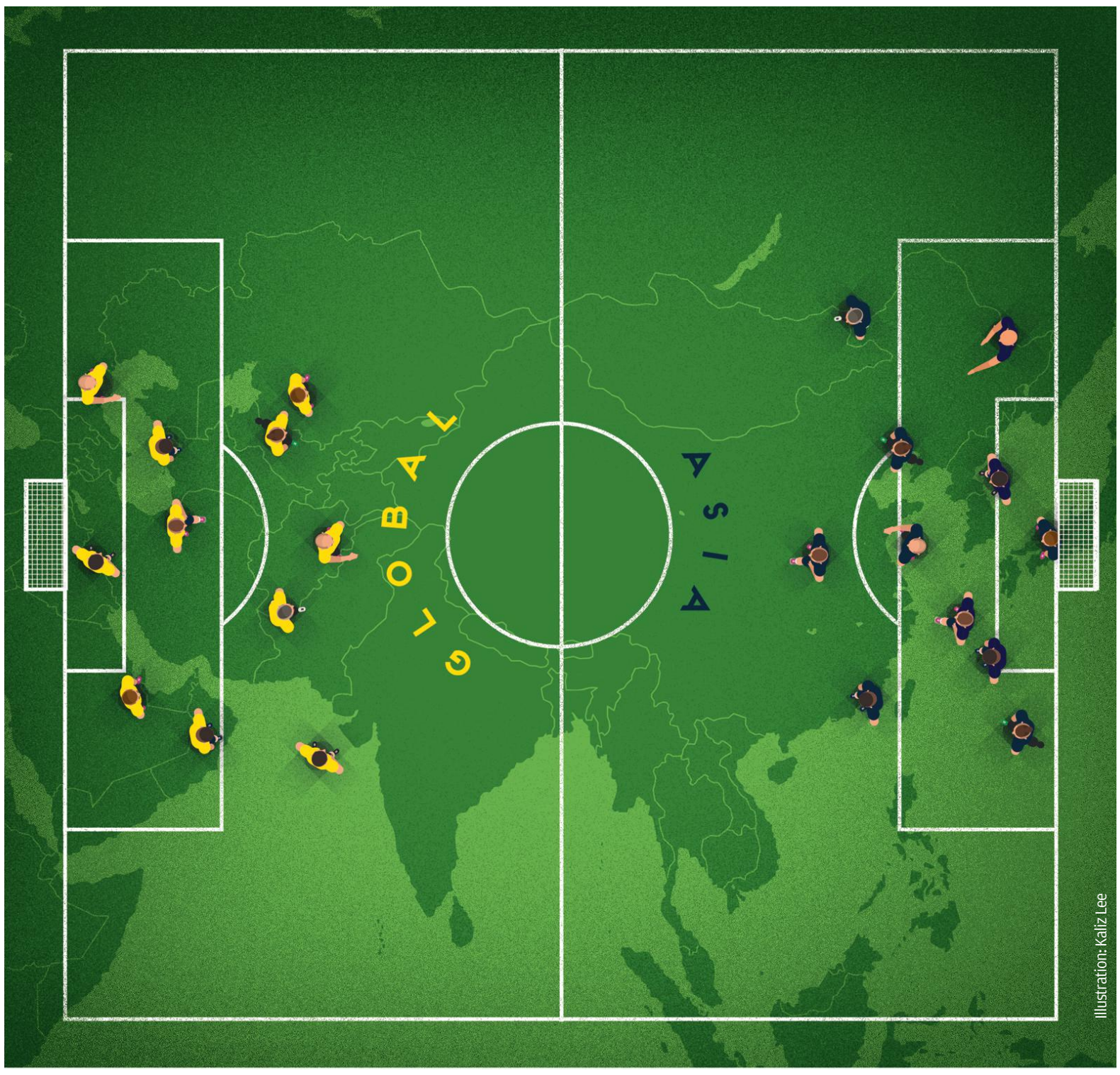

Illustration: Kaliz Lee

DO LOCAL FUND MANAGERS HAVE HOME ADVANTAGE?

Overseas and Chinese personnel both have their merits, but one thing is clear – it is time to take stock of the development in home-grown talent

Ian Potter and **Claudia Zeisberger**

Walk into any sports bar and a vigorous debate can usually be had about the merits of two teams, their style, tactics and stars' abilities. What is rarely debated is whether they are better at home. Rather, it is generally accepted that local knowledge, a strong network (read: fans) and familiarity with local conditions should confer an advantage on the home team.

And indeed, in sports, as in many other things, it does. Whether it is the recent example of stubborn and persistent success of English soccer club Burnley, which last season won 10 games at home versus just one on the road, or the disproportionate 73 per cent play-off series success of NBA teams with home-court advantage, most observers would accept that playing at home is likely to do some good and little harm.

The question is: does it apply in the private investment world and, if it does, why are there not more well-recognised local managers?

In order to try to understand the landscape in Asia, we will focus on private equity and venture capital, and put to one side the more niche areas of distressed investing, special situations, commodities and the like as those are smaller parts of the Asian pie.

There is little doubt that private investment had its modern origins in the West. The limited partnership structures that dominate the current form were developed in response to a US legal and tax environment and propagated outwards from there.

Similarly, the specialised private equity and venture investment skills were honed on the US' east and west coasts before crossing the oceans.

As a result, Western firms have successfully exported their expertise and business models, and global private equity and venture capital firms have been operating in Asia for decades.

More recently, it seems the ground is shifting. Local firms have formed to credibly compete for investors' capital, and one now has a far broader choice, so the question naturally arises: who is better?

This is frankly a question without a definitive answer and it is still very early (as most funds have 10-year lives). But to try to get a first impression, we will use the standards of the trade: when making their case for investor capital, most private investment firms, whether private equity or venture capital, will refer to both their absolute performance and how they fare relative to the competition as well as other metrics.

In the private investment business, much of the manager's skill lies in pattern recognition. Photo: Shutterstock

To be in the "top quartile" (or the top 25 per cent) of competing funds when measured by returns is viewed as a measure of success and indeed is used by many institutional investors as a filter for identifying good managers.

Historically, this "competition" has been from other global managers. Now, we are beginning to see sufficient returns data from local managers to be able to guess at the relative performance of the home and away teams.

In an article last November, we highlighted the recent acceleration of private capital investment in China since 2010, particularly at the venture capital stage.

Much of that capital has been managed by international funds, but an increasing proportion is being run by local investment managers.

When we looked at the relative performance of Chinese managers against international ones (determined by where the investment manager's headquarters and staffing sit) across private investments, we found that the top-quartile Chinese funds outperformed international managers by roughly 7.4 per cent over the period on a capital-weighted basis.

This is a striking difference, so we decided to look at Asia as a whole and found that local managers outperformed by 5.1 per cent.

That in turn led us to Europe, where the top home sides outperformed by a remarkable 9.2 per cent. So it would seem that across all stages and at a high level, there is local advantage.

> **7.4%**
>
> The percentage by which top-quartile Chinese funds managed by local managers have outperformed international managers since 2010

> An increasing proportion of [private capital] in China is being run by local investment managers

Do the numbers stand up to scrutiny at a more granular level?

When we further divided performance by asset class into private equity and venture capital groups, the results became cloudier.

In the private equity markets in Asia and China, local managers indeed outperformed their global peers. In the venture capital markets, however, the results were more mixed, and in the newer markets of Asia and China, international managers performed better. Why?

The private investment business is hard. But one could make a case that with more mature companies with lower levels of technology risk, much of the manager's skill is in pattern recognition.

In the same way that a good doctor treats what ails you because she has seen it before and is able to both diagnose and remedy the problem, a good private equity manager should be able to systematically improve the performance of a firm.

When Chinese and Asian markets were opening up to international capital, the restructuring and financial skills of the manager were in scarce supply.

Now those skills are taught in good business schools and are no longer as rare. In such a world, where the intellectual property and franchise benefits may be lower, private equity managers with experience in Western firms but who have based themselves in Asia should be able to compete. Add in superior local knowledge and they might quite well be able to outperform.

For venture capital, with the novelty, fragility and uncertainty of the invested businesses, the manager's networks and franchise leverage are likely to hold greater value and are less transferable (or more personal).

An investment from a well-recognised venture capital manager may allow the invested company to reduce its cost of capital from other sources, extend its marketing reach and attract better talent, reducing some of the risk to the business.

As a result, until local managers are able to demonstrate the sustained selection and mentoring skills to generate sustained returns, the advantage to the overseas managers may endure.

So what should an investor do?

Firstly, bear in mind the caveat that these are early conclusions in a long-cycle marketplace where the historical choices and biases are changing.

Assuming a manager's relative achievement and rank will hold is dangerous. As the ingredients of success change, so, too, will the winners.

It seems intuitive that where a skill is widely disseminated, other factors (such as better deal sourcing, local operational insights and value creation) will weigh more heavily in performance.

Opening your mind to talented local managers may not be only an intuitive conclusion, but also supported by the recent data – especially in private equity.

A final word, though, is that it is also fair to say the time series (biased to a largely post-global financial crisis history) has been a kind one for investors generally and venture capital in particular, and most local players are as yet somewhat untested in a downturn.

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