ISEN 617: Quantitative Models for Supply Chain Coordination

Case Study: Blue Nile and Diamond Retailing

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Introduction

Case study of Blue Nile and Diamond retailing teaches following things:

- Link between financial performance and supply chain structure of the company.
- The factors that drive supply chain performance.
- Factors' ability to perform during weak demand.
- Alignment of supply chain structure and place of the company in the market.

In this case study, we compared the performances of their diamond retailing companies (Blue Nile, Zales, and Tiffany) on various basis.

Blue Nile focuses on e-commerce with aggregation. Zales runs its business through stores but trying to enter into online channel and Tiffany also has online channel but high-end business takes place through stores.

In this case, three different supply chain structure is discussed, and performance is checked in terms of customer service, response time, variety of the product, availability of the product, customer experience, visibility of the order and returnability. Addition to those, company's cost factor is also considered like inventory, transportation, information, and facilities cost.

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1. What are some key success factors in diamond retailing? How do Blue Nile, Zales, and Tiffany compare on those dimensions?

Answer:

As with most retailing, the key success factors in diamond retailing can be measured by customer service factors and cost factors. Additional factors that play an important role could be product display and advertisement, product availability, suitable store location, efficient management, and credit facility.

Key drivers of customer purchases in diamond retailing include quality and range of products offered, reputation, professional advice offered, and customer perception and emotional bonds, including a positive buying experience and customer service. Success is also dependent upon obtaining economies of scale through such avenues as preferential access to resources, an effective supply chain, and marketing strategy, as well as an ability to control facilities and operating costs and manage inventory effectively.

First, considering the customer service factors, including customer satisfaction, purchase and experience throughout the process, differentiating Blue Nile, Zales, and Tiffany.

Given the varied supply chain components and supply chain costs, Blue Nile differs largely from the other two companies. Online sales have been most effective for high-value products with uncertain demand when customers are willing to wait a delayed time before the delivery. Also, the Blue Nile has a distinct advantage in product variety and product availability since customers can “build their own ring” considering the ranges along the 4 Cs(cut, color, clarity, carat) or by choosing from an inventory of about 75,000 stones. Customers purchasing at Tiffany and, until recently, at Zales have been limited to the inventory available at the store. Customers who are willing and comfortable making large purchases online will find the low-pressure purchasing experience at the Blue Nile, supported by the educational Web site, salaried sales support, and thirty-day return guarantee. Given that clients at the Blue Nile must be willing to wait to receive their orders as the jewelry is made to order, unlike at Tiffany or Zales.

The Tiffany brand is very strong and well established. This diamond retailer gained its significance in the industry by targeting affluent or wealthy buyers with a taste for excellence in fine jewellery. As it is associated with glamour, trust, and customer service, these associations allow the company to sell at higher margins than its competitors. Diamond and other high-end jewelry purchases are expensive, and many customers will trade-off other factors for the Tiffany customer experience when making such purchases. Moreover, when spending thousands of dollars on a single item, customers often want to see and feel what they are buying which kept majority of the customers from turning to other retailers. One of the reasons Tiffany could bounce back after the 2008 recession is that the wealthy customers continued buying the high-end products even after the hard times.

Zales is the least competitive among the three as it does not have the product variety and availability that the Blue Nile provides, nor does it have the brand name advantage that Tiffany enjoys. The weaker brand name has failed Zales in employing the upscale strategy which is reflected in the firm's margins, which are lower than those of Tiffany. The company lost the traditional customers without forming the new customer base. Then, under a new CEO, Zales started a transitiom to return to its role as a promotional retailer focused on diamond fashion jewelry and diamond rings.

To summarize the customer service factor for 3 retailres we can conclude that Blue Nile's, Zales', and Tiffany's key success factors in dealing with customers are related to the characteristics of their target markets. Blue Nile, for example, offers high-end products such as diamonds and fine jewelry online that are comparable to Tiffany's but with markups that are lower than Tiffany's and Zales'. Blue Nile focuses on customers who want good value and who prefer to shop conveniently from home and without incurring high-pressure sales tactics. Tiffany, which opened in 1834, is an independent, specialty jeweler that offers premium-priced high-end products. Tiffany's prestigious brand image, extensive service, and fashionable locations allow it to maintain and gain luxury market share domestically and globally. In contrast, Zales, a specialty retailer of diamond fashion jewelry and diamond rings in the U.S. since 1924, has high name-brand recognition and appeal to value-conscious shoppers. Zales offers more moderately priced and promotion-driven products compared to Blue Nile and Tiffany. It also competes with discounters such as Costco.

Second, considering the cost factors associated with each retailer to fulfill the customer requirements. Comparing Blue Nile, Tiffany, and Zales based on the costs incurred in meeting the requirements such as inventory holding costs, transportation costs, and facility costs.

Blue Nile's focus on low prices is reflected in the lower margins it has relative to both Zales and Tiffany. With its entire inventory at this facility, the Blue Nile operates out of one warehouse. The inventories at both Tiffany and Zales are disaggregated through their stores. High-end jewelry items are high-priced, have relatively low demand, and have uncertain demand. Most savings in invenotory holding cost can be realized through inventory aggregation as the safety stock inventory is reduced. Further, since items sold through the Blue Nile Web site are customized, the inherent postponement allows the company to keep inventory aggregated longer, thus reducing safety inventory even more. While Blue Nile's inventory-to-sales ratio is around 6 percent, the ratios for both Tiffany and Zales are about 40 percent.

Blue Nile operates primarily from one warehouse in the United States. Both Zales and Tiffany operate many stores, often in high-priced locations. In addition to stores all over the world, Tiffany has manufacturing facilities, a retail service center that supplies stores, and diamond processing centers in different countries. While Tiffany has advantages from being vertically integrated, Blue Nile operates on a very low fixed-cost structure. The operating income and number of total assests are very less for the Blue Nile compared to Zales and Tiffany. Blue Nile also has an advantage in facility operating costs. As the order is placed online, customers design, select, and order jewelry on the Web site, the company does not incur the costs associated in the form of human resources such as sales staff that Tiffany and Zales do.

As with most e-retailers, transportation costs are higher at Blue Nile than at Tiffany or Zales. The outbound transportation distance and hence costs and time tend to be much higher when inventories are aggregated, as is the case at Blue Nile. In the case of Tiffany and Zales, some economies of scale can still be realized on inbound transportation at all downstream stages of the supply chain until the merchandise hits retail stores, and the customer takes care of the last mile of outbound transportation costs.

Economies of scale and sourcing are achieved differently by each retailer. Because of exclusive supplier relationships that allow the online retailer to offer a manufacturer's diamond inventory without purchasing it until needed, Blue Nile has the most cost-effective business model. In addition to low warehouse and inventory costs, Blue Nile avoids the facilities investment expense and operating costs of the brick-and-mortar retailers. U.S. retailer Zales can obtain economies of scale because of its large number of stores but incurs high inventory costs. Tiffany sustains high-profit margins through its global and online presence, in-house manufacturing as well as established third-party sourcing which enables Tiffany to maintain tight control over its supply chain and reduce the operational risk.

To summarize the discussion for 3 retailers in general and how the retailers differ in their business dealings, the table shown below can be helpful.

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Factors	Blue Nile	Zales	Tiffany
Product Offerings	Engagement Rings, wedding bands, necklaces, pendants, bracelets, gifts accessories	Earlier they had gold now only Diamond fashion jewelry & diamond rings	High end products like diamond rings, wedding bands, gemstone jewelry & bands, non-gemstone gold, platinum & sterling silver jewelry, crystal & sterling silver serving trays
Target Customers	Men who prefer low pressure sales tactics	Teenagers, Working Class Mall Shoppers & upscale Gordons	High Income Customers
Product type & cost	High end products with lower markups (~20%)	Moderately priced promotion driven products	High end products with higher markups
Mode of selling	Only online	Initially offline stores, but later omnichannel	Offline stores + online
Inventory	Low	High	High
Cost, marketing & operations strategy	Exclusive supplier relationships, Low warehouse & no facility & operating expense of brick & mortar stores	High inventory costs, suffered due to change in product offerings & marketing strategy in 2006- 07 & hurt its bottom line	High profit margins due to global presence, established 3rd party sourcing, in-house manufacturing providing 60% of its centralized inventory management with control on its supply chain & with low operational risk

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2.What do you think of the fact that Blue Nile carries many stones priced at $2,500 or higher, whereas a large fraction of the products sold from the Tiffany website are priced at around $200? Which of the two product categories is better suited to the strengths of the online channel?

Answer:

Blue Nile and Tiffany both have employed different business policies to enhance their customer reach and profits. Both are targeting different customer segments and accordingly devise the strategies to fulfill the requirements. There could be different reasons why these two firms carry very different types of items on their Web sites for online retailing.

In the case of Blue Nile, the primary reasons could be the savings in inventory holding cost due to lower safety stocks and the broad product variety and product availability that the firm can offer customers. Stones priced at $2,500 or higher are unique, high-value items with relatively low demand and high demand uncertainty. The high demand variability necessitates carrying larger safety stock to meet required customer service levels. Given the high price of the stones, the cost of holding them in inventory is proportionally higher. Aggregating inventory reduces the amount of safety stock required since the demand variability is lower than in a disaggregated scenario. By aggregating the inventory in the online channel, Blue Nile also broadens the product availability and variety available to customers. Thus, it is a feasible way to aggregate and carry its high-priced products with low demand and high demand variability on an online channel.

The Tiffany brand is built on the glamour, luxury, and quality that customers experience when visiting a Tiffany store. This perception is based on both the products and the services provided. The company’s inventory includes a wide variety of items ranging from very high-end diamond jewelry to basic but elegant household items and watches. Tiffany has stores ranging from 1,300 square feet to18000 square feet and on average 7100 square feet selling high-margin products in affluent U.S. areas. Given the strategic importance of the brand image and the breadth of inventory, it makes sense for Tiffany to position the high-end luxury products at the store and move the D items to the online channel. This allows it to utilize the limited facility space to highlight the high-end items and customer service. Also, provides an opportunity for customers to handpick their choice of products. Moving the lower-end items online, where product substitution can be used as means of aggregating inventory and lowering safety stocks for the D items.

The structure employed puts Tiffany at a cost disadvantage relative to Blue Nile because Tiffany decentralizes its high-value items with low demand and high variety while centralizing its lower-value items. Such a cost disadvantage can be justified as long as Tiffany can maintain its strong brand and associate it with the store experience. Blue Nile can successfully offer diamonds that cost up to millions of dollars with a wide variety of high-end designs and options available and mark up prices that are comparatively lower than the retail stores. In comparison, Tiffany successfully uses a combination of over 180 exclusive worldwide retail outlets and online channels to provide high-end products as well as the D items to their customers, respectively. The main advantage for Blue Nile over retail stores is that it has lower facilities cost and inventory expertise. Only one central warehouse is needed to stock its entire inventory although outbound transportation costs are high because it provides home deliveries to their customers depending on their willingness to wait. On the other end, Tiffany utilizes its already-built-in warehouses, in-house manufacturing units, strong supply chain, and information infrastructure to facilitate sales of low-value products through the online channel. These lower-priced products increase the firm's potential customer base and improve margins by reducing operating costs.

3.What do you think of Tiffany's decision to not sell engagement rings online? What do you think of Blue Nile's growth into the non-engagement category?

Answer:

Tiffany introduced its new engagement ring setting and were famous for it. Initially it sold only stationary and fancy goods and then had high demand in the silver designs. Tiffany sold high end products including gold and diamonds in the retail stores. For the upscaling Tiffany had already set up many retail stores all over the country approximating around 275 stores. They sold engagement rings designed by many famous designers like Elsa Peretti, Paloma Picasso, the late Jean Schlumberger, and architect Frank Gehry in their retail stores.

The reasons for Tiffany not moving its sales of engagement ring online were as following:

1) Preventing brand dilution: This will affect the company as it will have too many brands distributed across many channels and it will be difficult to resource all of them equally. This will result in loss of brand value and will not be able to meet the expectations of every customer.

2) Margin sustainment: If the engagements rings were to be sold online, the basic requirement was that the price of the ring had to be reduced to compete with other online sellers who sold at a comparatively cheaper rate. This might result in the loss of overall revenue and will not be compensated by the sales, as the rings were high end and Tiffany had made a huge investment in the design of the rings and the material used in the rings.

3) Already settled retail chain: Moving online would have meant that the sales from the retail stores would be shifted to online websites. Initial investment in the 275 stores and well settled supply chain and marketing related to the stores will be disturbed if the rings will be sold online. The cost would be reduced for the ring and further closing the retail stores will incur more loss and hence will not be profitable for Tiffany.

4) The involvement of customers in the retail stores is easy than collecting customers online, the footfall will be increased once more and more customers come into the retailers and hence will increase the sales of other high price items like watches and household items too.

5) The sales of engagement rings and high-end products which are priced at an average price of $3000 will dominate the sales of non-gemstone products and the low-end products proceed at $ 200 and will lose its customers for that segment.

Blue Nile mainly focusses on selling engagement rings and had a strategy of giving them in low prices and have a very easy user interface with the customers making the buying process comfortable for them. Blue Nile saw a tremendous success in the engagement rings sales as they had low inventory cost also gained the trust of customers after they introduced the 30-day return policy. Their growth in the non-engagement sector is explained below:

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1) Increased target customers: Along with engagement rings Blue Nile sold wedding bands, necklaces, pendants, bracelets, and gifts and accessories containing precious metals, diamonds, gemstones, or pearls. This increased the target customer range and increased the overall sales.

2) The initial policy of keeping the margins low will help the company capture significant market share, just like the company did for engagement rings. This strategy will help Blue Nile to make more profits and increase their customer engagement.

3) They have a well settled engagement ring supply online and introducing the other products will help them to sell them in bundled sets. For example, the engagement rings can be sold with ring bands or with watches or pendants. This will increase the overall sales and the customers will not hesitate to buy a set of things together and hence will increase the overall profit.

4.Given that Tiffany stores have thrived with their focus on selling high-end jewelry, what do you think caused the failure of Zales' upscale strategy in 2006? What products should Zale focus on?

Answer:

Zale Corporation initially focused on selling jewelries in the strategy of "a penny down and dollar a week". They also established mall-based kiosks which included jewelries for teenagers and for working class mall shoppers. This showed the majority class which made purchase from Zale corporation. Zale also sold high end jewelries which were pricier in the fancier malls.

The declining market shares resulted in the loss of shares to many wholesalers like Walmart and Costco, this put a pressure on Zale and hence forced it to make some changes. The one change it made as mentioned in the question is that it introduced the strategy to drop the lower value jewelry and modest diamond sales and fully focus on pricier and fancier fashion trends. This strategy was a failure due to the incapability of Zale's to manage the Supply chain for these sales. This happened because it tried to reposition its suppliers and products in a very short period. Moreover, 15 percent of the suppliers were new and there was introduction of new overseas vendors. This resulted in the loss of premium customers as well as the traditional customers as the products for the traditional customers were sacked. Tiffany is a strong brand and is well settles, though Zale's tried to upscale the sales in the way Tiffanie's did they suffered from a high inventory cost, and the margins were not sufficient to counter this increase in inventory cost. Hence the poor strategy of sacking the traditional products and failure in supplying and stocking up the new premium products resulted in the failure of Zale's upgrade strategy in 2006.

For gaining back the advantage, Zale should focus on its initial plan of selling low value jewelry and targeting teenagers and working-class mall visitors. They should shift to the higher end products after a certain amount of revenue is generated with them and they should make the transition in a gradual manner which will not result in poor Supply Chain and will not lose sales for this transition.

5.Which of the three companies do you think is best structured to deal with weak economic times?

Answer:

A various main factor which defines the supply chain contribute hugely to cash flow of the companies during the weak economic times. These main factors will impact revenue during every sale period and will lead to success in supply chain.

Considering all these factors we can say Blue Nile will survive best in weak economic times and Zales will in the weakest position.

Blue Nile has the advantage because they have a very lean supply chain structure. They have very low fixed cost compared to Tiffany and Zales. This fixed cost can be calculated by Property and equipment to net sales ratio. For Blue Nile, it is 2.38, for Tiffany it is 13.93 but at the same time for Zales it is 25.46 which is very high. Blue Nile has very low investment compared to other two companies. Zales and Tiffany has medium- and long-term leases and Blue Nile has aggregated Warehouse. The selling, general, and administrative expenses at Tiffany and Zales is almost four times that of Blue Nile. This cost was added due to operating stores. Due to aggregation, Blue Nile has a very low investment in inventory compared to other two. Also, at Blue Nile due to lower margins and the higher cost of outbound transportation the cost of sales is higher. But in case of weak economy, low-cost structure at Blue Nile will be advantageous. This low-cost structure and lower prices will gain more market share. Blue Nile does not purchase most of its diamonds until a customer places an order so its bottom line will not severely impact by customers who will purchase less expensive jewelry and by those who will stop buying completely because of strong price-sensitivity. Before the downturn, the company increased its international Web site presence by launching sites in Canada and the United Kingdom and opened an office in Dublin. The Dublin office offered free shipping to several western European nations, while the US office handled shipping to Asian Pacific countries. This will help to gain sales international and to recover loss to due weak economy at a particular country.

Zales is in the weakest position to handle the weak economy because of the higher inventory levels and tightened credit. Similarly, Tiffany being stronger in the market may be survive during the weak economy, but sales will be dropped due to high fixed cost. Zales and Tiffany does not have low-cost structure like Blue Nile. During the weak economic times of 2009, Zales was most affected. The concentration for Zales' store was in north America whereas Tiffany and Blue Nile is dispersed geographically. Regaining market share among the middle-class customers and handle merchandising issue due to failed strategy begun several years earlier to go upscale in Zales. Additionally, a new CEO in 2006 who began the company's return to its traditional strategy based on diamond fashion jewelry and moderately priced diamond rings, had not been able to restore the company to profitability.

6.What advice would you give to each of the three companies regarding its strategy and structure?

Answer:

There is opportunity for improvement for all three companies to improve their supply chain surplus.

Blue Nile

This company mainly focuses on the lower prices with very large variety of stones. This is aligned with aggregated structure. It helps customers on the four Cs and third-party validation as market strategy. This will convince customer to purchase the stone without touching or seeing. Considering the low cost, customer will try to save money. So, Blue Nile will also have significant opportunity in weak economy, and they should take an aggressive position emphasizing its lower prices with similar quality to very high-end diamond retailers. They should continue focusing on its low price for high quality diamonds and on its unique shopping experience which is different from Tiffany and other Brick and Mortar style shops. They should expand international presence by launching more website and increase the marking in other countries. To increase the brand recognition and appeal, marketing efforts needs to be taken.

Zales

To reduce cost, Zales needs to reduce the inventories. They can go for centralization and aggregation of the inventory to reduce the cost and making available to the stores as per the requirement. Aggregation can be done for higher value stones whereas lower value diamonds could be stocked at retails stores for sales. For high value diamonds, instead of keeping the inventory similar imitation stones can be kept for physical sensation and to help customer to select a style. Real diamond can be installed later after order confirmation. Shipping to local store can be done for pick up from the customer. So, ideal scenario will consist of keeping the inventory of low value items & sale of it on the spot whereas high value stones centralized and provided on demand. Aggregation of high-end stones will tamper the brand image. They should work on reducing the overall supply chain cost which will result in reducing the selling price of the diamonds without reducing the brand image. More focus on wholesale and economies of scale business will give potential advantages to reduce margin and could give it some form of exclusivity on its stones. Also, sources of stones should be very similar to those of its competitors. Zales should expand their market all over the world to reduce the risk of economic down trend in North America. They should also try to reinforce the value of its brand with customers in the market. Special efforts should be taken to increase the e commerce business. This will gain more market share, generate revenue, and improve the supply chain surplus by lowering the operating costs.

Tiffany

To maintain the brand image, Tiffany cannot aggregate the stock of high value stones. With current strategy, pricing pressure at retail store will grow with the competition like Blue Nile, Walmart and Costco. So, Tiffany needs to work hard to maintain the brand image. Their strategy to take advantage of Economies of Scales by considering wholesale of diamonds had a lot of positive outcomes. It will give a lot of margin and could give some form of exclusivity on its stores. Also, the sources of stones are also very similar to those of its competitors. They should continue to increase its small store formats in the US and increase market share by direct selling channel. They should also grow international marketing to acquire market share of Asian luxury market and other potential emerging markets. With increasing cost of Diamond over the period, it might assess the advisability of participating in sales promotions which will be done for the first time. Main important step they should do is to increase overall supply chain efficiency and protecting its brand to stay strong in the market.