

5.26: Supply Chains - From Push to Pull

A supply chain refers to the flow of physical goods and associated information from the source to the consumer. Key supply-chain activities include production planning, purchasing, materials management, distribution, customer service, and sales forecasting. These processes are critical to the success manufacturers, wholesalers, or service providers alike.

Electronic commerce and the Internet have fundamentally changed the nature of supply chains and have redefined how consumers learn about, select, purchase, and use products and services. The result has been the emergence of new business-to-business supply chains that are consumer-focused rather than product-focused. They also provide customized products and services.

In the traditional supply-chain model, raw material suppliers define one end of the supply chain. They were connected to manufacturers and distributors, which, in turn, were connected to a retailer and the end customer. Although the customer is the source of the profits, they were only part of the equation in this “push” model. The order and promotion process, which involves customers, retailers, distributors, and manufacturers, occurred through time-consuming paperwork. By the time customers’ needs were filtered through the agendas of all the members of the supply chain, the production cycle ended up serving suppliers every bit as much as customers.

Driven by e-commerce’s capabilities to empower clients, most companies have moved from the traditional “push” business model, where manufacturers, suppliers, distributors, and marketers have most of the power, to a customer-driven “pull” model. This new business model is less product-centric and more directly focused on the individual consumer. As a result, the new model also indicates a shift in the balance of power from suppliers to customers.

Whereas in the old “push” model, many members of the supply chain remained relatively isolated from end users, the new “pull” model has each participant scrambling to establish direct electronic connections to the end customer. The result is that electronic supply-chain connectivity gives end customers the opportunity to become better informed through the ability to research and give direction to suppliers. The net result is that customers now have a direct voice in the functioning of the supply chain, and companies can better serve customer needs, carry less inventory, and send products to market more quickly.

Minicase: Zara's Global Business Model (Capell, Kamenev, and Saminather, N.(2006, September 4)).

Inditex, the parent company of cheap, chic-fashion chain Zara, has transformed itself into Europe’s leading apparel retailer over the past 10 years and has racked up impressive results in Asia and the United States. Since 2000, Inditex has more than quintupled its sales and profits as it has tripled the number of stores of its eight brands. (Zara is the biggest, accounting for two-thirds of total revenues.) More recently, Inditex increased its year-on-year net sales by 6% in the first nine months of its 2009 fiscal year to 7,759 million euros. Net income grew to 831 million euros. The retailer launched 266 new stores in the first nine months, bringing the group’s total number of stores to 4,530 by the end of October 2009.

Key highlights for the period included openings in Asian markets, with 90 new establishments inaugurated by October 31, 2009. These store openings reflect the strategic importance of Asian markets for the group and underscore a year of robust growth in China, Japan, and South Korea. High points of store launches so far this year include flagship locations in Japan and Mainland China.

In Japan, Zara now has a total of 50 stores, including a second flagship location in Tokyo’s Shibuya district, which is a must-see global fashion destination. Prior to this opening, Zara had already welcomed shoppers at another upscale store in Shibuya. Zara thus enhances its excellent retail presence in Tokyo’s four key shopping areas: the two aforementioned flagship stores in Shibuya, two each in Ginza and Shinjuku, and one in Harajuku.

Meanwhile, in Beijing, the group celebrated the opening of a flagship location in one of the Chinese capital’s busiest shopping hubs. The store, which opened its doors on the pedestrian Wangfujing Street, brings the group’s number of stores in China to more than 60. The company’s firm commitment to expansion in the Chinese fashion market is reflected in its decision to locate shops not only in Beijing and Shanghai but also in emerging cities such as Harbin, Dalian, Qingdao, Changchun, and Kunming.

To get where it is today, Zara has turned globalization on its head, distributing all of its merchandise, regardless of origin, from Spain. With more outlets in Asia and the United States, replenishing stores twice a week—as Zara does now—will become increasingly complex and expensive. The strain is already starting to show. Costs are climbing and growth in same-store sales is slowing: at outlets open for 2 years or more, revenues were up by 5% last year, compared with a 9% increase in 2004. So far,

the company has managed to offset that problem by charging more for its goods as it gets farther from headquarters. For instance, Zara's prices in the United States are some 65% higher than in Spain, brokerage Lehman Brothers, Inc., estimates.

Zara has succeeded by breaking every rule in retailing. For most clothing stores, running out of best-selling items is a disaster, but Zara encourages occasional shortages to give its products an air of exclusivity. With new merchandise arriving at stores twice a week, the company trains its customers to shop and shop often. And forget about setting trends—Zara prefers to follow them. Its aim is to give customers plenty of variety at a price they can afford. Zara made 30,000 different items last year, about triple what the Gap did.

Zara does not collaborate with big-name designers and or use multimillion-dollar advertising campaigns. Instead, it uses its spacious, minimalist outlets—more Gucci than Target—and catwalk-inspired clothing to build its brand. Their advertising is their stores. To get shoppers' attention, Zara is located on some of the world's priciest streets: New York's Fifth Avenue, Tokyo's Ginza, Rome's Via Condotti, and the Champs-Elysees in Paris.

Keeping those locations flush with an ever-changing supply of new clothing means striking the right balance between flexibility and cost. So while rivals outsource to Asia, Zara makes its most fashionable items—half of all its merchandise—at a dozen company-owned factories in Spain. Clothes with a longer shelf life, such as basic T-shirts, are outsourced to low-cost suppliers, mainly in Asia and Turkey.

The tight control makes Zara more fleet-footed than its competitors. While rivals push their suppliers to churn out goods in bulk, Zara intentionally leaves extra capacity in the system. That results in fewer fashion mistakes, which means Zara sells more at full price, and when it discounts, it does not have to go as deep. The chain books 85% of the full ticket price for its merchandise, while the industry average is 60%.

Zara's nerve center is an 11,000-square-foot hall at its headquarters in Arteixo, a town of 25,000 in Galicia. That is where hundreds of twenty-something designers, buyers, and production planners work in tightly synchronized teams. It is there that the company does all of its design and distribution and half of its production. The concentrated activity enables it to move a dress, blouse, or coat from drawing board to shop floor in just 2 weeks, less than a quarter of the industry average.

Consider how Zara managed to latch onto one of hottest trends in just 4 weeks in 2006. The process started when trend-spotters spread the word back to headquarters: white eyelet—cotton with tiny holes in it—was set to become white-hot. A quick telephone survey of Zara store managers confirmed that the fabric could be a winner, so in-house designers got down to work. They zapped patterns electronically to Zara's factory across the street, and the fabric was cut. Local subcontractors stitched white-eyelet v-neck belted dresses and finished them in less than a week. The \$129 dresses were inspected, tagged, and transported through a tunnel under the street to a distribution center. From there, they were quickly dispatched to Zara stores from New York to Tokyo, where they were flying off the racks just 2 days later.

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