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Sustainable Enterprise Program

Expanding the Playing Field: Nike's World Shoe Project (A)

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"To bring inspiration and innovation to every athlete in the world."

—Company Mission Statement

"We want to be able to shoe and clothe young athletes of the world regardless of where they live. To do it for really difficult socioeconomic situations is both challenging and rewarding."

—Tom Hartge, Footwear Director for Emerging Markets

The words "Just make me the shoe!" echoed down the boardroom table to Tom Hartge, a 17-year veteran of the running shoe company, Nike, Inc. Tom Clarke, president of the company in 1998, had attended the meetings, seen the presentations and reviewed the numbers related to the market potential of China: a rough gem with a booming population of 1.2 billion. He also knew that in many parts of the world, including China, people couldn't afford Nike's current footwear products. Clarke didn't want to listen to any more speeches. He wanted to hold in his hand a tangible prototype—a specialized shoe that could sell in an emerging economy. Nike's challenge was to "expand the playing field" with a range of affordable, durable, and easy-to-produce sport shoes. So with this command, Hartge, Director of Emerging Market Footwear, teamed up with long-time shoe designer Alex Gajowskyj, and in early 1998 began the development of the World Shoe Project, a footwear line exclusively intended for emerging markets in Asia, Africa, and Latin America.

This case was prepared by Heather McDonald and Ted London under the direction of Professor Stuart Hart, Center for Sustainable Enterprise, Kenan-Flagler Business School, as a basis for class discussion rather than to illustrate the effective or ineffective handling of an administrative situation. Copyright © 2002 World Resources Institute and Kenan-Flagler Business School at the University of North Carolina, Chapel Hill.

In early 1999, initial indicators were positive as the World Shoe line hit retail stores in China, as well as in Thailand, Indonesia, Malaysia, the Philippines, and other Asian and Latin American markets. In China, marketing studies suggested a growing population of sports enthusiasts and over 80 million Chinese with an annual income between U.S. \$10,000 and \$40,000.\frac{1}{2} Further, Nike faced little competition from other major international shoe companies. The World Shoe line was manufactured in China using local materials and Nike's existing manufacturing network, which helped to decrease import duties and other costs of production. These cost reductions, combined with a design-for-manufacture process that had a relatively small environmental impact, allowed for a relatively low-cost product for the intended Chinese segment. As another benefit, the local manufacturing and sourcing plan created jobs—and thus income generation—for local residents, who typically had little purchasing power. The \$15 retail price point held the potential to capture a huge new customer base and expand the range of Nike products offered in retail stores.

However, by January 2001, Hartge was faced with a dilemma: World Shoe sales were not meeting expectations. First, Nike struggled with the concept of selling low-margin products. There was no corporate flexibility with regard to profit expectations for the World Shoes. Even at \$15 a pair, the shoe couldn't compete with lower-priced, local brands. Another major problem was the company's limited distribution infrastructure in China. As a result, the shoes weren't widely available to consumers outside the major metropolitan areas where Nike sold its high-end footwear. Finally, no specialized marketing or advertising plan was created for the new product line. The shoes had been placed into the company's current retail channels with little explanation or promotion. In two days, Hartge would meet with CEO Phil Knight and his senior management team to decide the fate of the fledgling product line. Hartge wondered how to get Knight to fully support the promising concept of the World Shoe Project.

Company Background: The Swoosh

Recognized for producing the "best running shoes," Nike concurrently set fashion trends for teenagers and produced high-quality shoes for world-class athletes. Ads featuring sports heroes fueled dreams for playground kids and weekend warriors alike. The company had become an icon for athleticism in an era when athletes were revered unlike any time in sports history.

Controlling more than 45 percent of the U.S. athletic shoe market by 2000,³ the company experienced tremendous growth for three decades, pushing its revenues from \$60,000 in 1972 to nearly \$9 billion by 2000. During the previous two years, however, revenues had been disappointing. Exhibit 1 depicts Nike's 10-year financial history. Its solid research and development capacity, international sourcing, and outstanding brand image were the foundation of the Swoosh's success. The company had developed a core competency around contracting its footwear manufacturing in regions with inexpensive labor costs, and then exporting the shoes to wealthier markets.

Organizational Structure

With over 21,000 employees worldwide, the company was organized into departments by both geographic divisions and product categories, which created overlapping management responsibilities and a fluid leadership structure. For example, a footwear manager in Europe answered to both the Vice President of Footwear and the Vice President of Europe. However, there was no formal communication link between the regional vice presidents (those in the United States, Europe, Asia-Pacific, and Latin America) and the product vice presidents (footwear, apparel, equipment). In the case of the World Shoe Project, Hartge operated under the supervision of Jerry Karver, Divisional Vice President of Footwear, and the guidance of Dan Loeb, General Manager of Nike China. Exhibit 2 shows how the World Shoe Project fitted into Nike's organizational structure.

¹ More information from *Asia Megatrends* by J. Nasibett.

²"Nike Gets Picked as Best Running Shoe," *Smart Money*, November 1, 2000.

³Available at <u>www.hoovers.com</u>.

The Triple Bottom Line

In an effort to expand the "field of play" globally, Hartge and Gajowskyj knew that the company must consider not only its financial performance, but environmental and social issues as well. Others in the organization recognized this, too. Around Nike, the notion of sustainability, or "the ability of the current generation to meet its needs without compromising the ability of future generations to meet theirs," was well known among employees, due in large part to a push from the Corporate Responsibility department to educate the workforce on the "triple bottom line" model. Top management at Nike knew they would answer to shareholders and the public alike for the company's performance in these three areas—economic, environmental, and social. They responded by adopting various sustainability goals amidst trying economic times.

The Economic Bottom Line

Slumping sales, profits and stock prices had caused economic distress for Nike since 1998. Styles in the United States and Europe were changing, resulting in the Nike sneakers losing market share to brown shoes and baggy pants that were the latest fashion. The company's top line revenue figure was stagnant and hopes of improvement were, as always, pinned on the continued penetration of current markets. The United States and Europe carried 83 percent of total company revenues, while the Asia-Pacific region accounted for 11 percent and the Latin American region just 6 percent. Exhibit 3 depicts the revenue breakdown for each region from 1998 to 2000. Nike recognized it clearly needed to balance and expand sales in the global marketplace.

In addition to the risks of a concentrated sales focus in the Western world, the Asian financial crisis hit the company hard. Nike's manufacturers were facing tumultuous conditions: producing shoes in Asia changed from a low-cost proposition to a risky task. In July 1998, the company posted a fourth-quarter loss of \$67.7 million, its first quarterly loss in 13 years.⁵ These financial woes and the trends in the fashion world were deteriorating the Swoosh's ability to sell on brand image, creating a downward economic spiral.

The Social Bottom Line

At the same time, questionable employment practices, low wages, and poor working conditions at Nike contract factories in Asia garnered substantial negative international press. Student protests, grassroots organizations, and major network television shows, like 20/20, all honed in on what had originally been a key differentiator for Nike: cheap overseas labor. Nike had become, in essence, synonymous with "sweatshops."

After much criticism, Nike faced these issues head on and made several significant changes to its labor practices. First, the company enacted a worldwide monitoring program for all contract factories, using both internal auditors and independent consultant firms, Ernst & Young and PriceWaterhouseCoopers. The factories were audited on a continual basis to ensure compliance with the revamped Nike Code of Conduct, a policy on labor issues, which was translated into the language of the factory workers.

According to a survey conducted in July 2000, factories found that compliance with Nike's Code led to increased marketability. Many international manufacturing corporations, having learned a lesson from Nike's labor fiasco, were also concerned about labor issues. They recognized the high standards of Nike's Code, and therefore felt "safe" working with a factory prescreened and approved by this yardstick. Further, factory managers reported that the plants were better places to work than before the Code was enforced, testifying to increased worker morale and a cleaner work environment.

Nike also became a charter member of the Fair Labor Association (FLA), a nonprofit group that evolved out of an anti-sweatshop coalition of unions, human rights groups, and businesses. The FLA required that all members com-

⁴ For an elaboration of this definition, see World Commission on Environment and Development, *Our Common Future* (New York: Oxford University Press, 1987).

⁵ Nike Corporation, Annual Report 1998 (Beaverton, OR: Nike, Inc.).

⁶ McDonald, Heather, "In the Spirit of Continuous Improvement: A Look at Nike's Monitoring Process" (August 2000).

with guidelines outlined in its own code of conduct, including a local minimum wage standard and minimum age of 15 years. Additionally, Nike helped found the Global Alliance—a coalition including the International Youth Foundation, the MacArthur Foundation, the World Bank, and Mattel—which is dedicated to improving workers' lives in emerging economies.

Finally, in July 2000, Knight spoke to the United Nations, challenging other multinational manufacturers to endorse an international standard for labor practices. Although a costly investment for corporations and contract factories alike, Knight made a pledge to develop "an internationally recognized set of generally accepted social accounting principles and monitoring organizations certified to measure" companies' labor practices.⁷

The Environmental Bottom Line

Aside from taking responsibility for labor practices, Nike boasted a strong environmental conscience. For example, Nike launched the Reuse-a-Shoe Project in 1994 to down-cycle old, unwanted footwear at a rate of approximately 2 million pairs per year. Nike retailers collected shoes (regardless of brand name) and shipped them to Oregon, where Nike ground and separated the materials. Through partnerships with sports surfacing companies, the outsole rubber and midsole foam were turned into artificial athletic surfaces. Profits from this business unit generated income for the Nike Foundation and the funding of sport surface donations.

Further, the integration of sustainability principles guided research and development ideas, especially in the foot-wear department. One recent change included eliminating the use of some solvent-based glues in favor of water-based adhesives in footwear products. Also, footwear designers started evaluating their new prototypes against a "product sustainability" scorecard. The Footwear Sustainability department went so far as to set a target date of 2020 for zero waste, zero toxic substances, and 100 percent responsibility for what the company created.

The company went to great lengths to maintain wetlands habitat during the expansion of its Beaverton, Oregon, headquarters. Further, a company-wide initiative based on the tenets of sustainable development was initiated to educate employees about the concept of sustainability. Coined *Shambala*, the project's activities included incentivizing employees to begin carpooling to work and encouraging the workforce to swap their Styrofoam coffee cups for ceramic mugs emblazoned with the term "sustainability."

Irony Amidst Effort

Suffering from stagnating sales in primary markets and poor press on labor issues, Nike needed a new avenue for growth. The company knew a huge new market lay in emerging economies, especially China, if it could expand its "field of play" in these markets. The only Nike products available in China, however, were the same high-priced footwear and apparel lines that sold at a premium in the United States and Europe. As such, a fundamental irony ran through the business model. While approximately 180 million Nike shoes were sold annually, the workers who made them didn't have the purchasing power to buy them. Neither did the vast majority of Chinese consumers—the shoes were too expensive to compete in the massive local market. So how could Nike reach this market?

China: Manufacturing Partner or Marketplace?

During a tour of soccer fields and badminton courts at a university in Chengdu, China, Hartge and Gajowskyj came to the disturbing realization that among hundreds of athletes, not one was wearing any Nike product. Athletes played sports wearing mostly worn out, inexpensive canvas shoes. The two discovered that an athlete who played sports two to four times weekly would replace a pair of shoes six to eight times annually. The few pairs of more expensive, non-canvas "Western" brand shoes sat next to piles of clothing courtside, worn only for the trip to the game and then replaced with the cheaper shoes to actually play in!⁸

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⁷ "Nike's Phil Knight Starts at Top to Plead Case on Labor Practices," *The Oregonian*, July 30, 2000.

⁸ Gajowskyj, Alex, "World Shoe...and a Bic Biro."

Beyond simple observation, research statistics revealed the market demand for athletic shoes. According to a Nike-commissioned study of the Chinese sports market, 86 percent of the interviewees participated in some kind of "sport." This translated to over 1 billion "exercising people" in China. Over 49 percent of those surveyed claimed to ride a bicycle, which was also a primary means of transportation. Apart from cycling and running, badminton was reported as the most played sport in China. According to this study, 35 percent of Chinese age 10 or older played badminton at least once a year. In absolute numbers, this translated to 336 million players, a number Hartge felt couldn't be ignored. Exhibit 4 highlights the various sports activities of the Chinese population.

Hartge saw a twofold advantage of the World Shoe project. First, it made sense from a growth perspective. But equally as important for Nike's brand image, the initiative made sense from a triple-bottom-line standpoint. For one thing, it created more income generation in the regions where the company operated manufacturing facilities. Second, a product specially developed for the needs of the mass Chinese market offered local consumers their own affordable product line.

A New Business Model

To tap into this flourishing market, Nike needed a new strategy. The traditional business model of exporting and marketing footwear to wealthy top-tier markets simply would not fit successfully with this new segment. Customers' needs and purchasing power were different, retailers didn't operate in the same manner as in developed markets, and production and material costs would need to be seriously re-evaluated.

In 1996, before Hartge came on board full-time with the World Shoe Project, an Emerging Market Task Force was created to develop a new business plan for entry into such markets. Their strategic mission was "to enter and generate revenue by penetrating markets where Nike [was] not currently making an impact. Global in concept, local in execution." The task force was composed of individuals from footwear, manufacturing, strategic planning, and international footwear departments. They examined the company's current manufacturing, ordering and distribution policies, and drafted a new business model for emerging economies. The new plan included the concepts of "local-for-local" manufacturing, product development based on collaboration with local factories, and a target market classification system to determine the proper customer segment.

Local-for-Local Manufacturing

"Local-for-local" manufacturing was an integral part of the new business model. The concept was defined as "domestic-only manufacturing designed to provide the lowest cost solution for emerging markets." Using locally available materials that were purchased with domestic currency, the World Shoe line could be manufactured within Nike's existing factory network in China. Pursuing this strategy would reduce transportation costs, eliminate import duties, and remove the warehousing costs of the World Shoe line compared to other Nike footwear. Local sourcing also satisfied Chinese government regulations, as the company had to buy local materials if it intended to sell the shoes locally. Raw material import licenses were not granted to multinationals that wanted to make products in China for sale in the Chinese market. While this local-for-local production model made economic sense, it also supported the effort to integrate the triple-bottom-line concept into the new business model by sourcing materials from a broader range of local companies.

Product Design and Development

In contrast to traditional Nike engineering, where a designer created a prototype and then a factory figured out how to produce the shoe, a design-for-manufacture approach to the World Shoe's development was a key factor in cost

⁹ Survey conducted in 1997 by Roper and Associates of the Chinese Athletic Market.

¹⁰ Company document.

¹¹Company document.

Author's Note: Products that were going to be exported globally could be manufactured from materials that came from outside China. Only products created in China for the Chinese consumer had to be sourced locally.

reduction. The World Shoe team co-designed the shoe line in conjunction with the factory. Intense periods of on-site design collaboration with Asian engineers resulted in consistent fit and quality as well as the elimination of time-consuming and expensive manufacturing problems.

While not as sophisticated as footwear sold in western markets, the shoes were designed with a virtually waste-free "pillar cushioning" midsole and traditional Nike "Waffle" outsole. "A lot of what we did harkens back to the early work of Nike co-founder Bill Bowerman," Hartge noted. "The beauty of this project is we're going literally back to the original Waffle outsole, to bring this cushioning and traction technology to people who have not yet been able to experience it." Further, contrary to Nike's typical seasonality of products (footwear was designed for three distinct seasons: fall, winter, and spring), the World Shoes were developed for one season, and thus had a long shelf life.

Although not used in all World Shoe lines, Gajowskyj and other Nike footwear designers were exploring how to implement a technique dubbed "tessellation" for the World Shoe (as well as for other shoe lines). This design was based on interlocking pattern pieces that nest against each other, so when cut out they significantly reduce material waste, and therefore material costs.

To further reduce the environmental impact, Nike eliminated the typical shoebox for these shoes. Traditional card-board boxes had little re-use value and were not retailer-friendly in China.

Instead, a pair of World Shoes was packaged in a drawstring bag that could double as a small backpack "The bags have been a big hit," comments Hartge. "It's included in the price, and provides an extra practical product. It fits in with our local-for-local focus."

Market Classifications

In addition to new design and manufacturing practices, Nike faced the issue of identifying a prioritized list of emerging markets to penetrate. The team divided potential markets into five tiers roughly according to population and purchasing power parity (PPP).

Tier One included "large developed markets" defined by a population of greater than 50 million and PPP of greater than \$20,000. Such countries included the United States and Japan. Tier Two, "small developed markets," included countries such as Austria and Hong Kong, and represented populations greater than 15 million with \$20,000 PPP. China fell into Tier Three: "developing with high potential," characterized by a population of 1 billion and an average of \$2,000 PPP.

Nike further classified markets into two additional tiers: Tier Four-"limited potential", and Tier Five-"high risk, low return." Exhibit 5 further defines this classification system.

Having penetrated and nearly saturated Tier One markets, and recognizing the complexities and challenges of operating in Tier Four or Five, Nike's goal was to reach more consumers in Tier Three. The Nike team was aware that many consumers in Tier Three markets were accustomed to playing sports in inexpensive canvas shoes, and also to paying a low price for athletic shoes. For example, the company discovered that nearly 78 percent of all athletic shoes sold in China were priced between U.S. \$1 and \$30. Nike's high-priced footwear missed the bulk of the market potential. Exhibit 6 outlines the various price ranges and Nike's participation in the Chinese athletic footwear market as of 1998. With Nike's new business plan, which promised lower costs, the company felt prepared to compete in the lower retail price brackets.

Because of Hartge's tenure and experience in Latin American emerging economies, he was a natural fit to spearhead this project. By early 1998, Hartge had taken over the company's new department, and the task force disbanded. With a full-time director in place and a specialized business plan, Nike seemed ready to capture a significant portion of the Chinese market.

The World Shoe: On the Fields of Play

In early 1999, the World Shoe product line hit retail stores in China and other Asian and Latin American markets. The line consisted of two basic models: the Series 100, an entry-level canvas product with a simple rubber outsole, and the Series 400, which used high-quality performance materials and included midsole "foam" cushioning technology. The Series 100's retail price ranged from \$15 to \$22, and the Series 400 ranged from \$40 to \$45.

Sports specificity was achieved in the last production step of the Series 100. Overall shape, fit, and outsole traction were slightly modified from the basic Series 100 shoe. The shoes were then given specific names for their respective sport: Hoopster (basketball), Sportster (court shoe), Roadster (running), Kickster (soccer), Trainster (cross-trainer), and Youth Training (school shoe). Exhibit 7 illustrates shows several models.

Revenue and Margin Forecast

Conservative revenue and gross margin forecasts had been created by the original task force in 1997, before any shoes were actually sold in the marketplace. Gross margins for the World Shoe line were predicted to increase from fiscal year 1999 to 2001, adding \$64.3 million to Nike's profits. Although the overall company margin decreased by 1 percent with the addition of this project in 2001, the dollars margin increased from \$80.6 million to \$144.9 million. Table 1 highlights the incremental financial benefits predicted for the World Shoe project in China.

Table 1
Footwear Revenue and Margin Forecast, China¹³

• 0	FY'99	FY'00	FY'01
In-line Shoes			
In-line Pairs (thousands)	506	550	575
In-line Revenues (\$ millions)	\$150.50	\$183.00	\$192.00
In-line Gross Margin (\$ millions)	\$64.70	\$76.80	\$80.60
In-line Gross Margin (percent)	43%	42%	42%
World Shoe Project			
WS Pairs (thousands)	50	545	930
WS Revenues (\$ millions)	\$3.20	\$77.90	\$164.00
WS Gross Margin (\$ millions)	\$0.80	\$28.00	\$64.30
WS Gross Margin (percent)	28%	36%	39%
Nike Corporation	1		
Total Pairs (thousands)	556	1,095	1,505
Total Revenues (\$ millions)	\$153.70	\$260.90	\$356.00
Total Gross Margin (\$ millions)	\$65.50	\$104.80	\$144.90
Total Gross Margin (percent)	43%	40%	41%

Cost Structure

The underlying cost structure of the World Shoe line was crucial to its success. Consumers' low incomes and local competition in the shoe industry put significant pressure on the retail price, and forced the World Shoe team to meticulously monitor costs. The design-for-manufacture and local-for-local manufacturing practices had paid off in terms of cost reduction, resulting in significantly lower labor, overhead, and materials costs. The factory cost for the Series 100 and Series 400 was approximately \$5.00 and \$9.50, respectively. A breakdown of the costs of a Series 100 World Shoe compared to an average Nike shoe are shown in Table 2.

¹³ Company Document.

Table 2
Estimated Cost Breakdown: Average Nike Shoe versus the Series 100 World Shoe (U.S. dollars)¹⁴

Cost Component	Average Nike Shoe	Series 100 Shoe
Labor	2.43	0.72
Manufacturer's Overhead	2.13	0.67
Materials	10.72	3.47
Profit to Factory	0.97	0.33
Factory Price to Nike	16.25	5.19
Wholesale Price	32.50	10.00
Retail Price	65.00	15.00

Challenges

By January 2001, Hartge and his team had sold approximately 404,520 pairs of World Shoes to Chinese customers. Three key issues contributed to the disappointing sales. First, organizational disincentives, including rigid profit margin expectations, ran counter to the promise of emerging-economy markets: small margins but high sales volume. The World Shoe was overpriced and couldn't compete with the local, low-priced competition. Second, reliance on Nike's existing distribution system restricted Hartge's access to the intended segment. Third, no formal marketing plan existed to promote the new shoe line to current or prospective retailers, or to end consumers. Could the World Shoe Project survive?

Organizational Disincentives

Philosophically, Nike embraced entry into the Chinese market. A new business model was created, Hartge and his team were on board full-time, and a physical product was selling. However, the corporate financial goals and pricing formulas were not designed to foster the growth of products like the World Shoes. For example, Dan Loeb, General Manager of Nike-China, was expected to add a specific percentage (50 basis points) to Nike's bottom line, regardless of the volume of shoes that were sold. Consistent with this goal, it made more economic sense to focus on higher margin products, as opposed to the World Shoe. Further, some people in the company were worried that the World Shoes' simple design and construction would make the current counterfeit problem even greater. They were concerned that the shoes would be too easily mimicked.

Pricing and Competition

The costs of producing the World Shoe line were on target to compete in the marketplace. However, as Hartge and the team learned, the newly created business model for emerging markets did not transform the profit margin model to align with this new environment. This low-cost product was placed into the corporate pricing formula used for all Nike footwear products. The gross margin percentages for a Series 100 and Series 400 shoe were 35 percent and 50 percent, respectively. As a result, the World Shoes, while still cheaper than other Nike products, were overpriced compared to competing products.

In fact, the combined retail sales revenues of three multinational companies, Nike, Reebok, and Adidas, totaled less than two popular Chinese brands, Kangwei and Li Ning. Table 3 depicts these revenues for 1999. These Chinese competitors not only had low cost structures and low retail prices, but they also targeted the large mass market, not just high-end consumers. Retail prices of local competitors ranged from \$3 to \$30. Further, the Li

¹⁴ Company document.

¹⁵Company document.

¹⁶ The combined sales number includes both World Shoe and inline footwear products.

Ning company, named after the famous Chinese Olympic gymnast, had a full marketing program for China similar to that of Nike. They signed national athletes, ran advertising campaigns, and sold their products in eye-catching packaging. And the competitor was looking to expand internationally. In the 2000 Olympics in Sydney, Australia, not only the Chinese but also the French gymnastics team appeared in the arena wearing their Li Ning-brand wear. Li Ning represented Nike's biggest competition in the Chinese market.

Table 3
Athletic Shoe Retail Revenue in China (1999) (millions of U.S. dollars)¹⁷

Company	Revenue
Nike	260m
Adidas	150m
Reebok	50m
Total	460m

Company	Revenue
Li Ning	800m
Kangwei	250m
Total	1,050m

Counterfeit Sales

Counterfeit sales of Nike footwear and apparel products ran rampant in China. Nike estimated that in 1998, approximately 2,250,000 pairs of imitation shoes were sold, accounting for \$70 million in sales. The World Shoe offered a potential solution to this problem because of the lower price. But, antithetical to the emerging market philosophy, Nike's required high profit margin expectations prevented much progress in the elimination of counterfeits.

Availability to the Target Market

Although using the existing manufacturing network and distribution channels reduced the search costs of seeking new partners, these established relationships were originally arranged with the company's traditional export model in mind. The World Shoes didn't fit into this network as easily as Hartge had hoped.

Retail Characteristics and Distribution Network

Not only were the shoes overpriced because of inflexible margin expectations, they weren't easily available for the intended consumer market. Nike's high-end footwear products were sold to retailers in the metropolitan areas of Shanghai, Beijing, and Guangzhou, where the company's manufacturers were located. The World Shoe team also relied on Nike's traditional distribution channels to get the products to retailers in these areas. The Shanghai Distribution Center delivered the World Shoes, along with all other footwear, to government department stores, athletic specialty stores, and Nike retail shops in these three big cities. Thus, a \$15 World Shoe would sit on a shelf next to a \$150 Air Max shoe. While some may argue that this provided a broad range of styles and prices for customers, Hartge believed that such placement confused both customers and retailers. These two lines sought contrasting target segments, but were sold through similar retail channels, which often included large retail chain stores.

Interestingly, large chain stores in China accounted for less than 3 percent of the total retail sales value.¹⁸ Most consumer goods were sold through small "mom-and-pop" stores with limited storage capacity and therefore low inventory levels. In fact, a study estimated there were 9 million small, independently owned stores in China that had limited capital and usually occupied less than 300 square feet.¹⁹

¹⁷Company Document.

¹⁸ Dawar, Niraj and Amitav Chattopadhyay. "Rethinking Marketing Programs for Emerging Markets." *Working Paper 320*, June 2000. p. 8.

¹⁹ Ibid.

These retailers were difficult to penetrate for a few reasons. One, they were spread throughout the country and therefore extremely fragmented. Second, because of small storage areas, most shops maintained a consignment-based mentality. Thus, they did not want to carry a full truckload of men's size 9 Series 100 shoes, for example. So Hartge and his team on the ground in China had a difficult time convincing local retailers to accept the traditional Nike method of distribution for this low-margin footwear line. To alleviate this issue, in some cases, retailers would drive to the nearest factory that produced the World Shoe line and pick up a few boxes to then sell in stores.

Furthermore, the World Shoe experienced a channel penetration problem. Nike had 388 different points of sale in China, and earned on average \$670,000 per location. Conversely, Li Ning had 800 points of sale in the country, and average revenues of \$1 million per locale. Table 4 highlights the penetration and channel efficiency of Nike versus Li Ning. (Note: these figures do not list company profits, but rather total retail sales revenue for each brand.)

Hartge struggled with another serious question regarding distribution and retail channels. Were the people shopping in these urban centers really the proper target market? The typical low-priced World Shoe line consumer did not live in these metropolitan areas or have the same purchasing power. However, without a formal distribution infrastructure in these rural regions, how could the shoes get into the intended segment?

Table 4 Channel Penetration²⁰

	Number of 1	retail outlets
Point of Sale	Nike	Li Ning
Shanghai	30	25
Beijing	60	30
Guangzhou	42	10
Elsewhere in China	256	740
Total China	388	800
Revenues	\$260,000,000	\$800,000,000
Revenues/POS	\$670,000	\$1,000,000

Manufacturing and Order Policy Challenges

The "local-for-local" manufacturing plan was potentially a double-edged sword for Hartge. On the one hand, the concept reduced costs, complied with Chinese regulations, and provided local people with jobs and income. On the other hand, if demand picked up in the future, the World Shoe would be in trouble. Because only two factories were designated to produce the entire World Shoe product line, the project faced potential capacity constraints.

Nike contracted with approximately 50 factories in Asia to produce all its footwear products, 30 of which were in China. However, a clear distinction was made between "local" and "in-line" footwear. "Local" products (i.e., the World Shoe line) were to (a) remain within the country or region where they were manufactured, (b) be manufactured from materials available locally, and (c) be designed with input from the local consumers. Conversely, "in-line" products were (a) designed for global export to developed markets and (b) not tied to the manufacturing region. In-line products were manufactured at in-line production factories, which purchased materials from the lowest-cost provider, regardless of the origin of the inputs. Nike had no factories that just produced "local" only products, only hybrids and "in-line only" factories. The World Shoe had not experienced the demand to justify finding a factory to produce this line exclusively. Exhibit 8 shows each factory type.

²⁰ Company Document

Another barrier to the availability of the World Shoe was the company's formal ordering policy. Every month, country and regional sales managers had to submit a 3-month production commitment to the Inventory Order Management Group at company headquarters in Oregon. There was a minimum requirement of 2,000 pairs per style, and a maximum order limit of 10,000 pairs per month. After purchase orders were submitted to headquarters, no changes or cancellations could be made until the next month. This minimum order requirement and monthly ordering schedule created significant challenges for the new line.

For example, for the 1999 Chinese New Year, bookings for the China Series 400 hit 40,000 for a December delivery. While this demand was initially welcomed, it exposed the order-forecasting inadequacies that World Shoe routinely faced. Three months before the Chinese New Year the regional buyers for World Shoe could only forecast a demand of 10,000 units for December. Tied to this number because of strict ordering policy, there was no way for Nike to satisfy an increased holiday demand.

Lack of Strategic Marketing Plan

In retail markets in China, the storeowner is often the salesperson as well. Therefore, companies wishing to extend their branded products into new channels needed to establish a strong relationship with this owner, who, in turn, made recommendations to consumers. To access even the high-end markets in emerging economies, multinational companies needed a large, dedicated sales force and large amounts of capital. However, Nike didn't have the necessary human resources to forge relationships with new retail shops in such a decentralized market. In addition, the corporate marketing department didn't have special, targeted promotions for retailers or consumers. Marketing efforts were left in the hands of the regional managers, who often were more concerned about selling higher-margin footwear products. Thus, World Shoes sat on the shelves without any endorsement. Retailers were left without information on the unique features or intended market for the World Shoe line.

In addition, there was some debate among Nike managers about upholding Nike's strong brand image. Individuals within Nike were concerned that making a "cheap" shoe tarnished what Nike had spent years building: a higher priced, high-quality athletic shoe. Without a designated advertising program to explain the value of these low-cost shoes, retailers and consumers alike were left confused about Nike's brand image.

Closing

Because of his tenure and reputation within Nike, Hartge's opinion was respected among other Nike executives. But with all these challenges, Hartge and this team would need significant resources and support to make the World Shoe meet expectations. Hartge also knew that his heart was in this project—and his career depended on its success. While he recognized that a new business model had been created for the World Shoe, it didn't seem to be working in China. What business model would work best? What could Hartge do to convince corporate management to change the profit margin expectations? What would be appropriate sales, revenue, and profit goals for this line? How might he best position the line, given the local competition? Could triple-bottom-line considerations be used to his advantage? He had two days to develop a plan that would persuade Phil Knight.

Exhibit 1 21

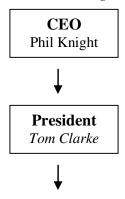
(in millions of U.S dollars, except per-share data, financial ratios, and number of shareholders) Nike's 10-Year Financial Performance

Financial Indicators	2000	1999	8661	1997	1996	1995	1994	1993	1992	1991	1990
Revenues	8,995.10	8,776.90	9,553.10	9,186.50	6,470.60	4,760.80	3,789.70	3,931.0	\$3,405.20	\$3,003.60	\$2,235.20
Gross margin	3,591.30	3,283.40	3,487.60	3,683.50	2,563.90	1,895.60	1,488.20	1,544.0	1,316.10	1,153.10	851.10
Gross margin (percent)	40%	37%	37%	40%	40%	40%	39%	39%	39%	38%	38%
Restructuring charge	(2.50)	45.10	129.90	,	-	1	1	1	1	1	1
Net income	579.10	451.40	399.60	795.80	553.20	399.70	298.80	365.0	329.20	287.00	
										243.00	
Cash flow from operations	759.90	961.00	517.50	323.10	339.70	254.90	576.50	265.3	435.80	11.10	127.10
Price range of common stock											
High	64.13	65.50	64.13	76.38	52.06	20.17	18.69	22.56	19.34	13.63	10.38
Low	26.56	31.75	37.75	47.88	19.53	14.06	10.79	13.75	8.78	6.50	4.75
Cash and equivalents	254.30	198.10	108.60	445.40	262.10	216.10	518.80	291.30	\$ 260.10	\$ 119.80	\$ 90.40
Inventories	1,446.00	1,170.60	1,396.60	1,338.60	931.20	629.70	470.00	593.00	471.20	586.60	309.50
Working capital	1,456.40	1,818.00	1,828.80	1,964.00	1,259.90	938.40	1,208.40	1,165.20	964.30	662.60	561.60
Total assets	5,856.90	5,247.70	5,397.40	5,361.20	3,951.60	3,142.70	2,373.80	2,186.30	1,871.70	1,707.20	1,093.40
Long-term debt	470.30	386.10	379.40	296.00	9.60	10.60	12.40	15.00	69.50	30.00	25.90
Shareholders' equity	3,136.00	3,334.60	3,261.60	3,155.90	2,431.40	1,964.70	1,740.90	1,642.80	1,328.50	1,029.60	781.00
Year-end stock price	42.88	60.94	46.00	57.50	50.19	19.72	14.75	18.13	14.50	9.94	9.8130
Market capitalization	11,559.10	17,202.20	13,201.10	16,633.00	14,416.80	5,635.20	4,318.80	5,499.30	4,379.60	2,993.00	2,942.70

Notes: All per-common-share data have been adjusted to reflect the 2-for-1 stock splits paid October 23, 1995, and October 5, 1990. The company's Class B common stock is listed on the New York and Pacific exchanges and trades under the symbol NKE. On May 31, 2000, there were approximately 153,000 shareholders of Class B common stock.

²¹ Source: company document

Positioning of World Shoes within Nike's Organizational Structure



	Footwear	Apparel	Equipment	Finance
United States				
Europe		N		
Asia Pacific	World Shoe Project			
Latin America	1			

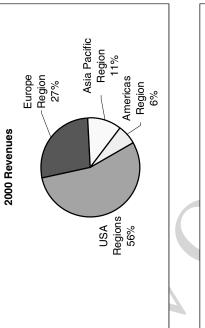
Nike's World Shoe Project (A)

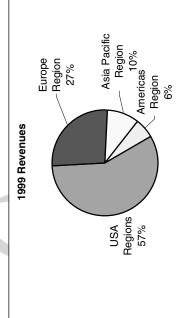
²² Source: company document.

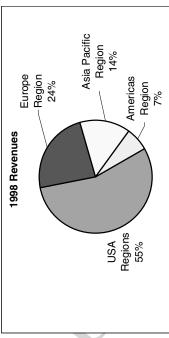
Exhibit 3 23

Revenue Breakdown by Region (as of FY ending May 31) (millions of dollars)

		_	-		-	
Products by Region	2000	1999	Fercent Change	1998	Fercent Change	
United States					_	
Footwear	3,351.20	3,244.60	3.3%	3,498.70	-7.3%	
Apparel	1,154.40	1,293.40	-10.7%	1,450.20	-10.8%	
Equipment and other	226.50	212.70	6.5%	224.20	-5.1%	
Total U.S.	4,732.10	4,750.70	-0.4%	5,173.10	-8.2%	7
Europe Region						
Footwear	1,268.60	1,182.70	7.3%	1,266.60	-6.6%	
Apparel	1,021.00	1,005.10	1.6%	795.90	26.3%	
Equipment and other	61.30	68.00	-9.9%	33.60	102.4%	
Total Europe	2,350.90	2,255.80	4.2%	2,096.10	2.6%	
		(
Asia-Pacific Region						
Footwear	557.00	455.30	22.3%	790.70	-42.4%	
Apparel	371.20	366.00	1.4%	453.40	-19.3%	
Equipment and other	26.90	23.20	15.9%	9.80	136.7%	
Total A-P Region	955.10	844.50	13.1%	1,253.90	-32.7%	
Americas Region						
Footwear	384.70	335.80	14.6%	403.00	-16.7%	
Apparel	152.00	158.40	-4.0%	186.20	-14.9%	
Equipment and other	13.50	12.90	4.7%	9.80	31.6%	
Total Americas	550.20	507.10	8.5%	599.00	-15.3%	
Total NIKE brand	8,588.30	8,358.10	2.8%	9,122.10	-8.4%	
Other brands*	406.80	418.80	2.9%	431.00	-2.8%	
Total Revenues	8,995.10	8,776.90	2.5%	9,553.10	-8.1%	/



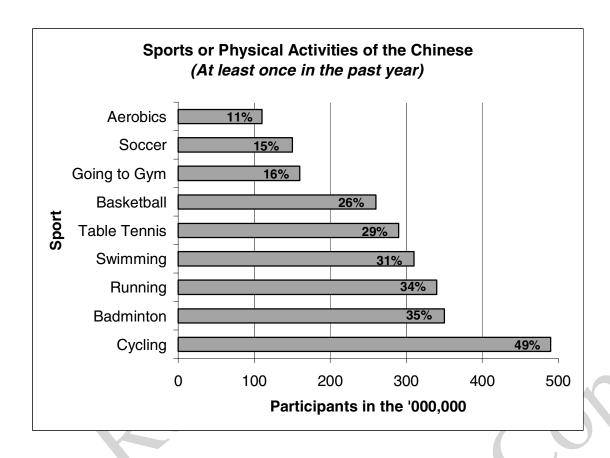




* Includes Nike-owned subsidiaries: Cole Haan, Bauer, In-house Manufacturing.

²³ Source: company document.

Sports Activities in China



Nike's World Shoe Project (A)

²⁴ Source: Roper Reports 1997 Worldwide Study, NIKE Consumer Insights.

Exhibit 5 ²⁵ *Market Sizing and Classification*

Tier	Characteristics	Population (millions)	Gross Domestic Product per Capita (PPP) (\$ thousands)	Example Countries
1	Large Developed Market	>50	>\$20	United States, Japan, France
2	Small Developed Market EU members	15	>\$20	Australia Australia
κ	Developing with High PotentialLarge population with a developing economyCountries slated to join EU	~1,000	\$2	India, China
4	Limited PotentialLimited growth potentialPotential currency, economic, or political riskGeographically isolated		<\$5	Israel, Turkey, Baltics, Brazil, Russia
W	High Risk, Low ReturnVery limited marketHigh currency, economic, or political riskGeographically remote		<\$3	Armenia, Belarus

²⁵ Source: company document

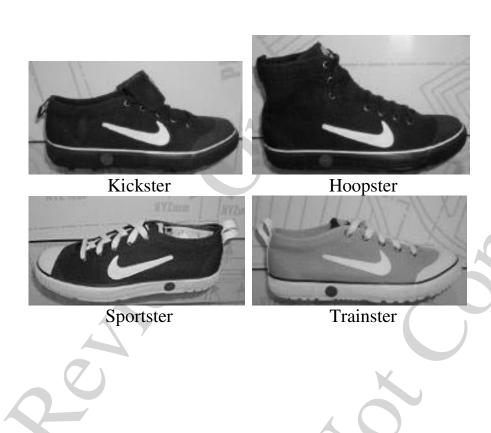
Exhibit 6 ²⁶
Chinese Athletic Footwear Market (1998–99)

Nike Nike 1999 Sales Market Share	(269,000 26.99	215,000 / 8.09	48,000 / 0.89	$\langle 6,000 \rangle / 0.19$	0.0%	90.0	$\langle 0.0 \rangle$	
Renmibi (RMB)	<u>></u> 650	450–650	350–450	250–350	150–250	50–150	10–50	
U.S. Dollars	>\$78	\$54–78	\$4254	\$30-42	\$18–30	\$618	\$1–6	
Market Size Percent of (units)	1,000,000	2,500,000	26.5 000,000,00/	/12,000,000 11.8%	/ 18,000,000	/ 12,000,000 11.8%	50,000,000 49.3%	

Assumptions: Market Size in Revenues is at retail including a 17 percent VAT

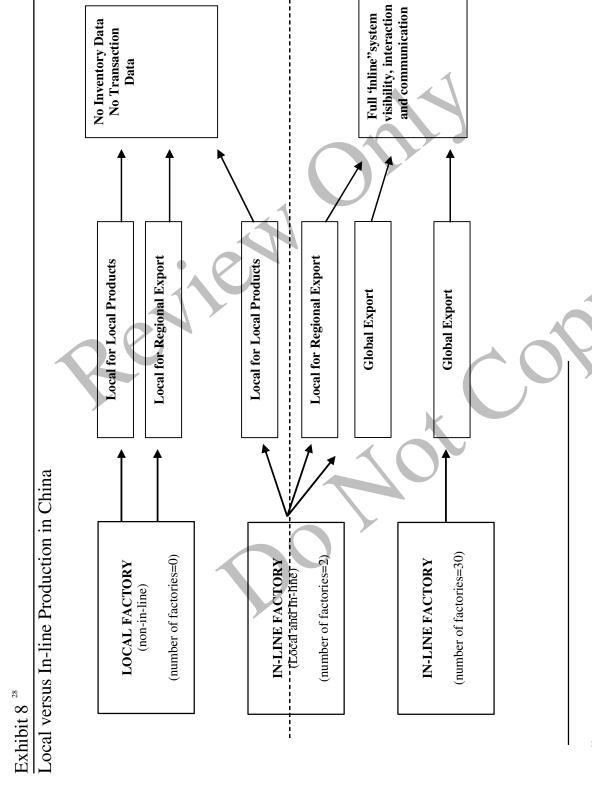
²⁶ Source: company document

Photos of the World Shoe Series



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²⁷ Source: company document.



²⁸ Source: company document.