Nike in china

Business, Company

Executive Summary Overview Nike is the market leader in athletic shoes in the United States. The Oregon based company has always utilized offshore facilities in low-income countries to produce at minimal costs followed by importation into predominantly the US for sales. Nike is quick to divest from emerging markets as costs rise and has recently signed short term production contracts with a long term strategy of production in China. Unlike Nike's previous global endeavors, the political and cultural atmosphere in China has made the collaboration more demanding. Opportunities

As the South Korean standard of living continued to improve, expected wages grew forcing Nike to look elsewhere for low cost shoe production. Market research identified China and India as the best long term possibilities for the new production facilities based on finances. Due in part to a trusting relationship between Nike and the Chinese government based on thefamilylines of vice president David Chang, China was determined to be the optimal location to grow. The possibility of a joint venture giving Nike access to a possible billion customer market was another opportunity that could only be found in China.

Issues in China Nike has spent the last four years building facilities, training staff, and developing relationships in China. Unlike other facilities in low GDP countries that had been utilized previously, the China collaboration has been less than successful. The current infrastructure combined with landlocked facilities made transportation logistics difficult. The Chinese government had certain expectations and standardization requirements that were misaligned with Nike's incentives in terms of quality, pay, pricing, and employeemotivation.

The PRC government also created difficulties in import/export restrictions causing logistical problems with raw materials, specifically anything entering the country through South Korea, a major Nike supplier. While a foothold in China could eventually lead to an enormous new customer base, the current global strategy was ill suited to take advantage at the current time. Options * Shift strategies in China from global to multi-domestic to take advantage of the market. This option would require the formation of a joint venture with the Chinese government. Move factory locations to reduce transportation and logistics issues. * Pull out of China completely. Recommendations We believe the government regulations will make quality improvement and cost effectiveness highly unlikely in China. Furthermore, a multi-domestic strategy requiring a high investment rate would be required to take advantage of the Chinese population as a new customer market. With low expendable income and a forced joint venture with the government necessary to sell Nike in China, we determined that selling in China is not currently an option.

As such, the team recommends an urgent identification of new possible production environments with a concerted and eventual total divestiture in China. Questions a. How has Nike conceptualized the athletic shoe industry: global or multi-domestic? Justify your answer. What are the implications of this conceptualization? Nike instituted a global strategy, as opposed to a multi-domestic strategy, from the company’s onset to compete in the athletic shoe industry.

Knight identified opportunities abroad to reduce costs in the upstream functions of the value chain. Through the coordination of overseas operations integrated with US downstream functions focused on local US markets, Nike's utilization of a Porter-defined global strategy has brought the company to China. The Far East's Role in the Value Chain Beginning with the first Japanese facilities, Nike factories located in the Far East, Europe, and South America have accounted for approximately 93% of shoe production with only minor assembly in the US.

The identified regions within this concentrated configuration were almost exclusively production-only facilities without the R&D, sales and marketing, and other downsteam services required for a successful multi-domestic strategy. The countries had been targeted due to low costs with certain factories being divested over the years due to increasing wage rates and political uncertainty. Competition to reduce costs between different countries was key to identifying new opportunities and deciding on which factories would remain open as economic factors changed.

While reducing costs was the main concern in global production, Nike could not accept a subsequent loss of quality. Previous experiences in Far Eastern plants had proven successful via quickly acceptedtechnologytransfer and ratios of grade-B shoes falling below 5% at rapid rates. Without the combination of high value and low cost, the strategic competitive advantage would be lost. Assumptions and Implications of a Global Strategy Nike moved to China based on their strategic history of standardizing the operations life cycle. Knight believed China would mirror other Far Eastern locales.

Cost cutting assumptions included pay based on relative Chinese wages (as opposed to relative Nike production wages), employee incentives capabilities, minimal import/export barriers, and an infrastructure for facile distribution logistics. For each unforeseen difficulty encountered along these assumptions, Nike's costs would increase and could drive margins down to a point where China would no longer be financially competitive. The Olympic team public relations venture attempted to further the relationship between Nike and the Chinese government, not to present a new product for the public.

The millions spent were misaligned with a low cost model and were identified with past exploitations by the West. While the possibility of two billion feet was enticing, Nike was in China to produce, not sell, shoes. There was no plan to market, distribute, or sell in China. Accordingly, the idea of a joint venture should not be on the table under the current strategy. However, the PRC strongly pushed JVs and the lack of a true collaborativeenvironmentcould be detrimental in an environment so heavily regulated. b. Speculate on the reasons for Nike wishing to enter China.

Before the entry do you think these reasons were valid? Justify your answer. China's Excellence in Manufacturing China is known for their excellence in manufacturing. Nike intended to exploit this excellence in order to drive down their supplier costs, while maintaining their customer's willingness to pay constant which creates value for Nike's customers and shareholders. Prior to entry and based on Nike's due diligence, this was a valid reason.

However, Nike either underestimated or did not entirely comprehend the challenges of conducting business is China.

From the difficulty of sourcing local materials to the inconsistency in quality of the finished product, China was not the optimal manufacturing location for Nike. Rapid Growth of the Athletic Footwear Market in the 1970’s (& Bad Forecasting) Perhaps Nike did not do enough high quality market research to see that the growth was slowing in their market. Nike may have become complacent due to their dominance in the industry or Nike may have discounted the market trends in the athletic footwear industry that showed a decline in the rate of growth, when comparing the 1970’s to the 1980’s.

The bottom line is that Nike did not accurately forecast and adjust their strategy to the athletic footwear industry trends and market conditions. Prior to entry and based on Nike’s due diligence, this was a valid reason. Nike chose to enter China, in part, to meet the demand of the growing market. However, perhaps they should have spent more time and resources on market research, which would have revealed that the growth rate was declining, and perhaps additional suppliers were not necessary to carry out their business plan after all and that a different international location might better meet their sourcing needs andgoals.

Rising Costs from Existing Suppliers One of the reasons Nike planned to enter China was due to the costs of conducting business in other countries (for example, South Korea and Taiwan) had been increasing. Nike thought that they could source product from China at a lower cost than their current offshore producers. Prior to entry and based on Nike’s due diligence, this was a valid rationale. Due to the multiple issues that Nike faced in China, the costs associated in producing a pair of shoes were actually higher in China than their other international producers. See Table A in the appendix for a landed cost comparison from the case.

Two Billion Feet Although the case clearly specifies this is not a reason for entry into China, one of Chang's motives may have been to sell directly to the Chinese. The size of the Chinese population is over three times the size of the United States. Even though the shoes produced in China were for the US, Chang may have considered producing a low cost shoe for the Chinese. Perhaps Nike's long term strategy was to navigate the Chinese political system, develop a strong local production presence, and then ultimately sell low cost footwear directly to the Chinese market.

This reason was not valid prior to their entry. Nike's product was not produced for the Chinese, as the average Chinese consumer could not afford the product. b. How did the decision to enter China complement Nike's overall strategy? Nike's decision to enter China was based on flawed information. Nike underestimated the inherent challenges (political bureaucracy, materials sourcing, shipping and transportation, quality control and the Chinesecultureof non-motivation and non-commitment) they faced when conducting business in China.

Nike also failed to accurately forecast the demand in the athletic footwear industry. The decision ultimately hurt Nike's overall strategy, as their production costs rose, while the demand for their product was declining. Higher cost and declining demand both negatively affected Nike's bottom line. c. Identify the entry and ownership strategies used by Nike in entering China. Do you think they were appropriate? Base your analysis on the entry and ownership strategies outlined by Robock and Simmonds, referenced above. Justify your answer.

As costs started to rise in other Asian markets, Nike made the strategic decision to open new full-scale manufacturing facilities in China, with the goal to reduce production costs. Nike's entry strategy into China created obstacles in achieving their long-term goals, which they should have foreseen. Below are a few factors that contributed to the obstacles. External Factors Nike underestimated the scope of the Chinese bureaucracy. Nike's only choice was to hire a consultant to navigate the issue. This consultant increased Nike's costs of doing business in China.

Furthermore, Nike overestimated the size and future growth potential of their target market. Nike should have conducted additional due diligence and more thorough market research before deciding to move into China. In addition, Nike did not forecast the materials sourcing issue, which added to product costs. Internal Factors Nike failed to forecast/implement some key factors when deciding to enter China. Nike lacked the necessary internal operations to actively manage and solve production problems in real time. Also, Nike had great difficulties communicating the issue of quality control to the Chinese.

Furthermore, the Chinese managers and workforce lacked motivation to perform their jobs to levels satisfactory to Nike. Ownership Nike chose to be wholly owned. Nike did not pursue the joint venture route, even though

China tried to persuade Nike otherwise. Nike did, however, hire a consultant as a strategic partner to help them navigate the challenging bureaucracy. Given the political climate in China, perhaps Nike should have approached China with a joint venture agreement. Having China as a partner may have saved Nike time and resources when launching a new manufacturing platform.

Or, perhaps Nike should have formed a strategic partnership with a local footwear manufacturer in order to bypass some of the issues with starting an entirely new facility and would have had some assistance in navigating the local market. d. Would you say Nike's entry into China was a success? Give reasons for your view, explaining why the entry was successful or afailure. At the time ofcase study, Nike’s entry into China was not a success. This evaluation is based on several reasons primarily due to the cultural clash between Nike and Chinese production.

By1984, Nike encountered a range of problems—from quality issues (only 80% of Chinese shoes were A-Grade), to inventory management (records kept on a guess method of expected usage), lack of flexibility from Chinese managers, motivational issues with management and workers, as well as complex and difficult government relations. Quality Issues in Product and Management When China’s reformist leader, Deng Xiaoping, opened China to foreign investment and global market opportunities, Nike seized the opportunity to buy a finished shoe product from the PRC as a long-term, low-cost supplier.

However, despite China's opening to the global market, it still existed as a socialist state with severe trust issues and obstructions to the free flow of information. These factors compounded to cause an array of production difficulties. Due to the Chinese factories still producing 20% B-grade shoes (significantly higher than both South Korea and Taiwan), Nike management not only wasted additional time arguing with Chinese managers on the quality problems (rather than actually improving the problem) but Nike also had to hire additional inspectors for each factory.

While themoneyspent to hire these inspectors was relatively low, this illustrates the need for oversight and the lack of faith and trust in the Chinese managers to run the factories to Nike's standards. Governmental Regulation Additionally, as a socialist state, Chinese workers lacked motivation to increase production (factories at a standstill by midday) and to adhere to production schedules since they would be paid the same regardless of output. Even attempts by Nike of monetary incentives only appeared to have an effect for approximately 60 days.

Because of the central planning system, the Chinese managers were used to stable prices. Price negotiations proved extremely difficult as none of the actual participants in the negotiations (foreign trade bureau, factory directors, local production bureau leaders) had the authority to make price decisions—everything relayed to authorities in Beijing. Compared to Korea or Taiwan, negotiations were slow which was extremely detrimental in a global and ever-changing environment. The levels of bureaucracy in China were much higher than those encountered in South Korea or Taiwan.

Although Nike tried to establish a positive relationship with China (through contributions to the country's sports activities and hosting various Chinese officials visiting the U. S.), meeting with the high-live leaders in China did not prove useful. The Chinese bureaucracy made making decisions difficult as it was never apparent who was in charge of what and Chinese officials did not show the same level of interest in establishing a relationship with Nike (leaders sometimes did not show up for appointments).

Ultimately, all of the cultural difficulties resulted in extremely low production numbers (Nike originally targeted production growth to 1, 000, 000 pairs per month by mid-1980's but annual production in 1984 was only 700, 000 pairs), significantly lower than both South Korea and Taiwan. Although Nike had ultimately hoped for a 20% price advantage over Korea, they were still losing $1. 00 on each pair of PRC shoes while the quality was much lower on these shoes as well. e. Identify the options available to Nike regarding its operations in China.

If you were Chang at the time of the case, what future course of action would you recommend in China? Options Some of the options available to Nike regarding its operations in China are to pull operations out of China completely or consider entering into a joint-venture agreement with China. As of 1984, Nike's foray into China has not been a success due to a variety of reasons (listed above). If Nike were to pull operations out of China, they would risk losing all of the equipment investment as well as damaging the sensitive and already tenuous relations ith the government. Other countries would have to be evaluated as a low-cost source of production. Some possible countries could be Indonesia or shifting a greater percentage of production to Taiwan as their comparative changes in unit labor cost, although increasing, were significantly lower than Korea or Taiwan. However, if Nike did decide to stay in China and enter into a joint-venture agreement, this step would potentially be viewed as a sign of trust and evidence of commitment by China.

Nike would also be allowed to sell its products in China—a significant market to consider with a population of 1 billion people. Nike would also have additional freedoms with regards to hiring and dismissing personnel. The costs of a joint-venture agreement though, were estimated at $500, 000 per factory and worker salaries would be about 20% higher than local factories. Recommendations to Nike If we were Chang at the time of the case, the future course of action that we would recommend to Nike would be to pull out of China operations.

Although the possibility of access to a market with 1 billion people seems counter to this decision, China's great strides in opening to global markets indicates the likelihood that Nike will be able to access this consumer at some point without having to make the commitment of a joint-venture agreement. Additionally, while recognizing the sunk-costs bias, we feel that the potential costs to continue operations in China would result in Nike still losing money on each pair of shoe produced instead of cutting their losses and finding another profitable production avenue.

Conclusions Nike saw China, as well as the many impoverished nations where previous production had occurred, as a part of the supply chain with a cost effective advantage. Korea and Taiwan had become increasingly expensive and China was a long term option. Unfortunately, Nike did not understand the political or cultural implications for utilizing China as part of a global strategy. The political environment and infrastructure in China created unforeseen difficulties for Nike in building an efficient production system.

Government controlled wages reduced the influence of incentives for both work efficiency and quality. Strained relationships with the South Korean government made importation of materials slow and expensive. Transportation logistics and regional cultural differences made the government suggested sites for initial factory locations less than ideal. China's two billion feet did not align with Nike's global strategy. The Chinese public could not afford the high costs for the Nike brand and current ROI expectations could not be achieved.

The Chinese government's relationship approach to external companies would have much greater acceptance towards a mutually beneficial joint venture. Some saw Nike's global strategy as exploitation. The financial impact of Nike's strategy could not be delivered in China. The collaborative relationship desired by the Chinese government was misaligned with Nike's needs. Together, it becomes apparent that the best option for Nike is to locate a better location for production urgently and completely divest in China.