Integration, Incentives and Innovation
Nike’s Strategy to Improve Social and Environmental Conditions in its Global Supply Chain

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Nike’s approach to managing supplier responsibility has greatly evolved since the 1990s, when the media uncovered claims of child labor, underpaid workers, and poor working conditions in several Asian countries. This report explores how Nike’s approach to improving social and environmental conditions in its global supply chain has evolved through integrated management of sustainability and innovation, increased supplier incentives, and systems innovations intended to prevent problems before they arise. The article focuses in part on a new system of rating suppliers called the Manufacturing Index, which gives sustainability equal weighting alongside the traditional supply chain measures of quality, cost, and delivery. Also discussed is Nike’s pipeline for innovative manufacturing and sourcing projects that have the potential to extend the company’s sustainability model beyond compliance, to one that builds social, environmental, and economic value.

Background
“Sustainability will be at the nexus of transformation in business, economies, and markets,” stated NIKE, Inc. President and CEO Mark Parker in the company’s 2011 corporate sustainability report. Like many multinational firms, the world’s largest footwear, apparel and sporting goods company faces innumerable complexities in managing social and environmental issues among its 700-plus contract factories in 42 countries. The company’s approach to managing supplier responsibility greatly evolved over the last two decades, with the company establishing a robust system of supplier monitoring, auditing, and remediation. Despite using an expansive monitoring program, Nike found that many factories continued to yo-yo in and out of compliance. In 2009, Nike launched project “Rewire” and transformed its approach from focusing primarily on compliance to one that gives supplier incentives to improve their social and environmental performance, since they are now evaluated on sustainability factors in addition to cost, on-time delivery, and quality.

Nike’s “Rewire” approach to supply chain sustainability has involved making several changes in the company: Transitioning to a more integrated organization structure, delivering lean manufacturing training to build workers’ skills and improve efficiency, developing a new supplier incentive scheme, and promoting innovation to engage all relevant stakeholders in creating the environment needed for systemic change to take place. This study explores three key aspects of responsible supply chain management that Nike believes will influence performance going forward: Integration, incentives, and

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Integrating Sustainability with Supply Chain Management

Rewiring Nike’s approach to supply chain sustainability has involved changes both at the company level and with its suppliers. Within the company, Nike changed its organizational structure to better integrate sustainability within traditional corporate functions. The company uses a matrix organizational structure in which managers report to multiple departments. Based on business unit goals, employees develop strategies and plans detailing their multidisciplinary responsibilities. Internal scorecards are used to report progress towards the goals. As part of this shift, Nike’s Sustainable Business and Innovation (SB&I) team is now formally part of the innovation team, and the SB&I leadership either reports to or works closely with sourcing and manufacturing, product design, product creation, strategy, finance and marketing organizations. With each department accountable for sustainability performance, Nike can better integrate sustainability into business decisions much earlier in the design process, rather than after-the-fact. Top company management has driven this transformation with initiatives being led, and accountability shouldered, by top management. According to Andrew Ogilvie, Nike’s Senior Director for Labor Excellence & Innovation, while the matrix approach can be complex, it has helped to promote the integration of sustainability within the company. Ogilvie further stated, “We have integrated sustainable innovation within Nike's growth strategy and, as a result, we have found leverage points within our matrix to accelerate change.” Cross-department scorecards are used to report Nike’s progress toward achieving goals and targets.

At the factory level, when training contract manufacturers, the company uses an integrated model that addresses a full range of issues influencing sustainability, including lean manufacturing, Human Resource Management (HRM), health and safety, environmental compliance, energy management, and environmental sustainability. The principles of lean are aligned with sustainability best practices such as reducing resource use and waste, valuing the workforce, and reducing downtime, all managed under a continuous improvement system. Nike’s practice of encouraging lean manufacturing by its contract manufacturers embraces the philosophy of continuous improvement, which aims to lead to increased productivity through a more skilled and engaged workforce. Nike’s contract manufacturers are trained and encouraged to implement lean principles by empowering workers to create innovative solutions that improve productivity. Ultimately, this can lead to both increased worker satisfaction and gains in business performance. Moreover, it believes respecting and empowering workers are critical to improving labor conditions in its supply chain, as opposed to simply increasing their wages. At the end of FY 2011, 80% of footwear, 57% of apparel and 11% of equipment was made at Nike’s contract factories using processes meeting Nike’s minimum baseline definition of lean.

Penalties and Incentives: The Manufacturing Index

Implemented in 2011, the Manufacturing Index (MI) is a business model innovation that “elevates the importance of sustainable manufacturing practices”, according to Hannah Jones, Vice President of Sustainable Business and Innovation (see Figure 1). The MI provides a consistent framework for measuring performance across Nike’s supply chain, brands, and products. The index is used to monitor, measure, and reward suppliers on quality, on-time delivery, cost, and sustainability performance. Each of the four categories receives a 25% weighting. The 25% weighting given to sustainability is one of the highest the authors have come across in their research to date. The sustainability dimension of the index covers environmental, social, lean implementation, and health and safety issues. The MI program has

grown from a handful of factories in 2011 to 79 supplier groups (a total of 144 contract factories) by 2013.

Based on scores in each category, factories are awarded a score between 0 and 100, putting them in a gold, silver, bronze, yellow or red category. While many companies penalize suppliers for non-compliance with their code of conduct, Nike has put into place incentives aimed at changing supplier behaviour for the better. Suppliers achieving the minimum acceptable level (bronze) in sustainability, cost, delivery, and quality qualify for receiving priority consideration for orders. High performing suppliers can also access Nike leadership and training on issues such as waste and energy management, and the implementation of lean practices.

Only after being compliant can suppliers access Nike’s leadership and resources. The adoption of this “pull” model incentivizes suppliers to achieve the highest performance possible in order to benefit from the MI incentives. This ultimately helps to promote supplier ownership of responsible practices, which benefits Nike and contract factories as well. This pull model is different than the more commonly adopted “push” model, where firms invest in suppliers that are frequently under-performing and not complying with minimum standards. Nike is interested in doing business with more proactive and high performing suppliers. Contract factories may only become an approved Nike supplier if they achieve the minimum bronze compliance standard from the outset. The company has set a target that all of its products will come from factories that have achieved bronze or higher status by the end of FY20⁴.

In terms of sanctions, suppliers performing at yellow or red levels can be subject to serious review. When issues arise such as detection of uncontrolled hazardous waste, a supplier must create an action plan to address and remediate the issues within a defined time period after which a follow-up audit is conducted. If satisfactory progress isn’t made, the supplier may experience a reduction in orders or, depending on the severity of the issue, eventually be considered for removal from the supply base. Suppliers receiving yellow or red ratings are also required to fund third-party audits until they can achieve and maintain the minimum bronze status.

Implementing the MI has taken substantial effort from both Nike and supplier management to ensure goals were aligned. Nike selected factories to implement the MI based on strategic importance rather than willingness to participate. In alignment with the “pull” model, Nike wants to work with suppliers that are investing in their future and in sustainable practices. Interestingly, Nike has reduced its supplier base from over 1,000 factories in 2009 to less than 800 in 2013. This allows the company to strategically manage a source base, build capacity, and grow with the contract factories that are philosophically aligned with similar business and sustainability objectives.

As of 2013, 79 supplier groups (a total of 144 contract factories) are part of the MI program. Nike says it is too soon to tell whether supplier performance is improving as a result of the MI system; most suppliers have only been a part of the program for three or four quarters. Some sustainability investments suppliers have made have a longer time horizon before they yield results. For example, several suppliers are investing in management development training and capital infrastructure projects to reduce water, waste, and energy use.

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While the impact of the MI rollout may take time to realize, some supplier factory managers have reported that they have a far greater understanding of their business performance expectations because of the scorecard and incentives structure. Presenting the MI in a clear dashboard format has helped both Nike and its suppliers evaluate their performance against targets.

**Innovation in Product and Process Design**

In addition to business model innovations such as integrating sustainability within business departments and improving the supplier incentive structure, Nike has also been focused on collaborative product and process design innovations focused on environmental sustainability. The company has targeted innovations that can prevent environmental issues and still create value for the customer.

> “...only innovation will make the difference because these issues are simply too big and complex for Nike or any one business to address on its own. We need coalitions to drive systemic change at scale.” Hannah Jones, 2013⁵.

Several recent product design innovations have been successful. In 2010, World Cup football shirts were made from recycled plastic bottles and developed using the Nike Materials Sustainability Index, which enables product creation teams to select environmentally better materials. More recently, Nike’s Flyknit technology was used to deliver a lighter shoe for runners that uses fewer materials. The shoe uses “essentially a single thread”. Since the one-piece upper does not use the multiple materials and material cuts used in traditional sports footwear, the shoe reduces both waste and cost.

Nike is also investing in manufacturing process innovations. For example, it made a minority investment in Dyecoo, a Dutch technology firm, which seeks to create the first commercially available waterless textile dyeing machines. By using recycled carbon dioxide to transfer the dyes, Dyecoo’s technology eliminates the use of water in the textile dyeing process. The textile industry is one of the largest consumers of water, and most of the world’s textile suppliers are located in Asia. The scale of the industry’s activity in the region can put pressure on the availability of clean water and contribute to environmental pollution in the discharges from manufacturing processes. By removing the need to use water in the dyeing process and eliminating the risk of effluent discharge, a known environmental hazard, Dyecoo could bring significant benefits to the region, as well as reducing the environmental impact of its own supply chain.

Finally, in an effort to harness collective innovation that can raise the bar for sustainability across industries, in 2009, Nike formed LAUNCH with NASA, USAID and the US Department of State. LAUNCH is a collaborative effort to generate “open source” innovations related to sustainability and accelerate potentially successful innovations⁶. The initiative has brought together stakeholders across the system such as multinational firms, suppliers, material providers, academics, and chemists in adjacent industries. In 2013 the LAUNCH focused on catalysing action around one of the world’s biggest challenges – the sustainability of product, who makes it, what it’s made of and how it is made.

6. Conclusions

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Nike’s approach to improving social and environmental conditions in its global supply chain has evolved to focus on integrated management of sustainability and innovation, increased supplier incentives, and systems innovations intended to prevent problems before they arise. While there is limited empirical research on responsible practices leading to improved social and environmental performance, Nike has undertaken important changes that it believes will improve social and environmental performance in its supply chain.

In terms of integration, Nike’s Rewire strategy has been driven from top leadership and resulted in a new organization to align goals between business functions in terms of sustainability, and the public targets it sets. In the manufacturing and sourcing team, for example, the MI was integrated to evaluate its source base including dimensions of sustainability, quality, cost, and on-time delivery performance. While the company acknowledges some challenges to its integrated, matrix organizational structure, Nike finds it allows for clearer integration and collective accountability of sustainability goals. In addition, Nike’s hypothesis is that integrated training programs for contract factory managers and workers such as lean and HRM are helping to drive systemic change. Lean builds worker skills by giving them a voice to suggest how Nike can improve but also has business benefits by increasing productivity through efficiency and quality control. HRM builds factory management capabilities to create a skilled and valued workforce.

In terms of incentives, Nike’s innovative MI is a leading example of how a company can move away from a more traditional compliance approach and a “push” model to manage sustainability issues, to a “pull” model, which incentivizes suppliers for performance. By offering suppliers incentives, imposing sanctions and measuring performance on a supplier’s balanced scorecard, suppliers better understand the importance of sustainability. This pull approach is helping to reward and develop suppliers who are committed to growing their business using social and environmental performance as a source of competitive advantage.

Finally, innovation is helping Nike to achieve its ultimate destination: “A truly sustainable supply chain”. Jones says her epiphany on sustainable operations came when visiting a Nike contract manufacturer where there was concern about monitoring employees to ensure they wore protective masks. Jones realized monitoring wasn’t the solution; the requirements for a mask needed to be designed out of the manufacturing process. The company introduced water-based solvents which was beneficial for the health of the worker and the environment. In order to achieve Nike’s long-term vision for sustainability, it recognizes that collaboration with other firms and stakeholders is vital. Solitary private efforts are often insufficient for impactful systematic change. This realization reflects the company’s focus on using innovation to proactively “design out” problems in the supply chain in both products and processes.

In summary, the company’s recent Rewire strategy shows how the company is now pursuing a more holistic approach to improving supply chain sustainability. While the program is too new to evaluate its impact on supplier sustainability performance, company managers are optimistic that positive changes will take place.

Nike has embraced a long-term perspective. Improving sustainability performance often involves heavy investment initially, with benefits being realized over a longer term.
If benefits from Nike’s efforts to integrate, incentivize, and innovate continue to materialize over the next few years, more firms may begin to adopt similar principles to drive sustainable supply chain performance to higher levels.

References


About this research
The Stanford Initiative for the Study of Supply Chain Responsibility (SISSCR) is an initiative of the Global Supply Chain Management Forum at the Stanford Graduate School of Business. The initiative is exploring the relationship between global supply chain social and environmental responsibility and business performance. The objectives of the research are to: (i) develop a framework for supply chain responsibility; and (ii) explore the relationship between responsible supply chain practices and business performance. To learn more visit http://www.gsb.stanford.edu/scforum/sisscr.
Figure 1. The Manufacturing Index