



NIKE, Inc. in the 1990s (C)

“Over the past two years, we have taken the company, formerly known as the industry leader in athletic shoes, and transformed it into a global brand franchise with an unprecedented level of market leadership,” stated Nike Chairman and CEO Phil Knight, in conjunction with the release of the results for the fiscal year ending May 30, 1997.¹

In early 1996, Knight had set a goal of doubling Nike sales from \$6 billion to \$12 billion in five years. During the 1997 fiscal year, Nike sales reached \$9.18 billion and after-tax income reached \$795.8 million (see **Exhibit 1**). Non-U.S. athletic footwear revenues grew 42% to \$2.4 billion. International athletic apparel sales rose 67% to exceed \$1 billion. Combined international revenues of \$3.48 billion represented 38% of Nike’s total sales. Analysts believed Nike wanted to generate half its business outside the United States by 2000. This objective seemed credible given the average American spent \$20 on Nike products, versus \$4 in Japan, \$3 in Germany, and 2 cents in China.

In the two years prior to May 30, 1997, Nike sales had increased 89% and Nike’s stock price had advanced 180%. Nike held 37% of the worldwide athletic footwear market and 47% of the U.S. market (versus 16% for Reebok, its closest rival). Phil Knight had appeared on *Business Week*’s list of the top 25 managers of 1996, and *GQ Magazine* had named him the fourth-most powerful man in professional sports. Tiger Woods, to whom Nike was already paying \$8 million a year for endorsing its products, was about to become the youngest-ever winner of the U.S. Masters golf tournament. Things looked good for Nike.

The Downturn

Two quarters later in 1997, Nike’s growth engine had clearly stalled. Nike reported a 20% profit decline for the quarter ended November 30, breaking a string of 12 quarterly gains in profits.² The details included the following:

- Total revenues increased 7%.
- U.S. athletic footwear sales fell 3%, U.S. athletic apparel sales rose 12%.
- Nike sales rose 5% in Europe, 18% in Asia-Pacific, and 40% in the Americas.

¹ Greg Harrell, “Just Buy It,” *Houston Chronicle*, June 29, 1997, p. 1.

² The quarter ending November 30 was the second quarter of Nike’s 1998 fiscal year.

Professor John A. Quelch prepared this case as the basis for class discussion rather than to illustrate either effective or ineffective handling of an administrative situation.

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- Gross margins fell to 37.5% from 39.4% in the corresponding quarter of 1996.
- Worldwide futures orders for athletic footwear and apparel scheduled for delivery between December 1997 and April 1998 were 1% lower than in 1996—10% lower in the United States, 23% higher in Europe, 12% lower in Asia-Pacific (especially in Japan), and 20% higher in Latin America.

Philip Knight stated:

This slowdown in futures orders clearly signals that revenue growth in the second half of fiscal 1998 will be below our previous expectations. This is largely a result of the slowdown in the Asia-Pacific market. . . . We see higher close-out sales on a worldwide basis continuing to negatively impact gross margins. We believe we have the strategies in place to reduce this excess inventory and allow us to grow the athletic footwear and apparel markets on a worldwide basis.

Analysts offered various explanations for Nike's fading performance:

- As Nike extended its reach to more and more sports, the swoosh logo became increasingly pervasive and was not seen as special any more.
- New products were based on gimmicks and minor advances, insufficient to motivate many consumers to buy new sneakers before their existing shoes wore out.³
- Nike's pricing, which reached \$180 per pair at retail on "Penny" Hardaway basketball shoes, was increasingly viewed as excessive, even by inner-city youths.
- Adverse publicity regarding working conditions in the factories of Nike's Vietnamese and Indonesian subcontractors helped boost sales of competing U.S.-made brands. Following an expose in 1996 on the CBS television show *60 Minutes*, Nike sent Ambassador Andrew Young of Goodworks International to inspect its subcontractors' plants and to endorse its code of conduct.
- Scandals in the world of professional sports, often involving bad behavior by athletes whom Nike paid handsomely for endorsements, affected sales of signature products.⁴ Nike was criticized by competing sports for offering athletic role models big money to endorse and wear Nike products. The Nike culture of being hip, brash, and controversial seemed to encourage bad behavior and was not appreciated in many international markets.
- Generation-X consumers in their twenties shifted from sneakers for streetwear to "brown shoes" such as hiking boots and walking shoes; by 1997, "brown shoes" accounted for 10% of the athletic footwear market.

Whatever the causes, Nike's retail customers were concerned. At the Foot Locker Division of Woolworth and the Footaction unit of Melville Corporation, Nike brand shoes and apparel accounted for 60% of sales. To secure sufficient allocations of Nike's latest products, retailers believed it was

³ Bill Richards, "Tripped Up by Too Many Shoes, Nike Regroups" *Wall Street Journal*, March 3, 1998, p. B1.

⁴ Signature products carried the name of the sports superstar who endorsed them.

necessary to follow Nike's guidelines for the retail pricing and merchandising of the company's products.

Smaller brands, as well as Reebok and Fila, sought to take advantage of Nike's weakness. Both New Balance and Airwalk announced a tripling of their advertising budgets for 1998. New Balance, with sales of \$560 million in 1997, saw itself becoming the Nike of the Baby Boom generation, with more width selections but fewer model changes.⁵ Airwalk, a marketer of lower-priced alternative shoes, aimed to "straddle fashion and performance with products grounded in alternative pop culture and extreme sports."⁶

Responses

Athletic footwear Nike planned to focus on penetrating the soccer market, mindful that soccer rather than basketball was the most important spectator sport around the world. Nike held only 6% of the soccer shoe market in 1997, but began to use its financial muscle to raise the value of endorsements. Nike paid \$20 million in 1994 to sponsor the Italian national team; in 1997, Nike paid \$200 million to sponsor the Brazilian national team.

Nike planned to continue four waves of new product launches each year, backed by a \$50 million research and development budget. Although this policy necessitated closeouts to make shelf space available for the latest wave of new product, it put great pressure on Nike's smaller competitors. Reebok had launched DMX technology in ultra-lightweight running shoes in 1997, but the technical merits of this product had been largely lost in a sea of other new product launches including Nike's Zoom Air. All objective tests indicated that, despite the search for new technologies to boost a brand's reputation for performance, no shoe or sole design yet invented could give an athlete any more lift.

Apparel and accessories Nike apparel sales had increased at an exceptional pace since the company entered the apparel business in 1983. According to Tom Clarke, apparel might grow to 40% of total sales by 1999 as athletes such as Tiger Woods dressed from head to toe in the Nike lifestyle and the swoosh logo.⁷ By 1997, however, Tommy Hilfiger Corporation, Polo/Ralph Lauren, and Donna Karan International were extending their reach beyond fashion apparel into sports apparel and, more recently, into athletic footwear. The sports apparel market was becoming increasingly cluttered and competitive.

Apparel sales were almost half of revenues from Nike's retail stores, factory outlets, and NikeTown superstores. NikeTowns were designed to entertain consumers as well as to display merchandise; they included climbing walls and minibasketball courts on which products could be tested. There were 10 NikeTowns in the United States at the end of 1997 (including one on Newbury Street in Boston, Reebok's backyard), with four more planned by 2000 plus international locations in London and Berlin.

The Nike name could also be found in the United States on watches, sunglasses, and other accessories manufactured under license to strict quality standards.

Sports equipment In 1996, Nike entered the sports equipment market when it purchased Bauer Inc., a leading Canadian manufacturer of ice hockey skates and sticks. Nike also hired Voit Sports Inc. to manufacture footballs and colored basketballs. In both cases, the initial new products

⁵ Joseph Pereira, "Sneaker Company Tags Out-of-Breath Baby Boomers," *Wall Street Journal*, pp. B1, B6.

⁶ Jeff Jensen, "Performance, Shoe Tech Takes Ad Stage for '98," *Advertising Age*, January 26, pp. 3-36.

⁷ Linda Himelstein, "The Soul of A New Nike," *Business Week*, June 17, 1996, pp. 70-72.

launched under Nike's auspices failed in the marketplace. Some analysts believed that Nike would conquer the fragmented \$40 billion sports equipment market and turn it into the "third engine" of company growth, buttressing athletic footwear and apparel.⁸ Others noted entrenched competitors such as Rawlings Sporting Goods and lower unit margins on equipment compared to sneakers (30% versus 50%) and argued that Nike was unlikely to crack the market.

New advertising As revenues grew, Nike continued to invest 10% of sales in marketing. Reebok and Adidas invested 11.5% and 12.5%, but on much smaller sales bases. By 1997, Nike's "Just Do It" slogan was over 10 years old and thought by some to be "tired." Management decided to launch a new slogan ("I Can") during the college football games on January 1, 1998. The advertising execution depicted "more human" athletes rather than deified superstars. Bob Garfield, an advertising critic, described the new campaign:⁹

I can, says one spot, in crude block type, overlaying the usual arresting pictures of sweaty athletes resolute in the agonizing face of defeat and uncertainty, intercut with equally arresting shots of sporting triumph.

*I can be strong.
I can have impossible goals.
I can master pain.
I can endure.
I can be the next Jordan.
I can celebrate without rioting.
I can make you remember me.
I can make you respect me.
I can give more than just sweat.
I can be afraid.
I can be afraid of nothing.
I can hang on, win gloriously, lose gloriously
I know I can.*

Garfield continued:

Why take a theme of sporting transcendence and pare it down to a pep talk?
Why spend tens of millions of dollars a year on Michael Jordan and a pantheon of endorsers if all you want to be is Tony Robbins?

Instead of the swoosh, the "I Can" ads segued off with the Nike name written in lower case script.

Competition

During the 1990s, Nike significantly extended its share lead over its longstanding rival, Reebok. In 1995, Reebok had declared its intention to become a sports and performance company rather than a fashion and fitness company. However, inconsistent advertising and brand imagery plus frequent management turnover stymied Reebok's sales and stock price (see **Exhibit 2**). Meanwhile, Fila gained share by positioning itself primarily as a fashion rather than performance brand. At the May 1996 annual meeting, CEO and President Paul Fireman (who owned 14% of Reebok) stated he would step aside if his turnaround plan "does not pan out over the next 24

⁸ Athletic footwear was a \$20 billion market worldwide and sports apparel was a \$30 billion market. See Bill Richards, "Nike Plans to Swoosh Into Sports Equipment But It's a Tough Game," *Wall Street Journal*, January 6, 1998, pp. A1, A10.

⁹ Bob Garfield, "Nike's New 'I Can' Just Doesn't Do It As Well," *Advertising Age*, January 19, 1998, p. 47.

months.” The plan involved canceling unproductive athlete and team endorsement contracts, focusing on the most important retail chains such as Foot Locker and Sports Authority, extending the Reebok name to apparel and licensed merchandise, signing a joint venture to market Ralph Lauren athletic footwear, and launching new high-tech sneakers under names such as Vishex and DMX. Despite these efforts, Reebok’s 1997 sales were stagnant at \$3.6 billion. Fireman blamed soft demand in Asia and excess retail inventories.

At the end of 1997, Adidas, not Nike or Reebok, was the hot company in the industry, both on Wall Street (see **Exhibit 2**) and Main Street. Adidas sales for 1997, reported in February 1998, were \$3.5 billion, up 42%, and pretax profits were \$372 million, up 52%.

Adidas had been founded in Germany in 1920 by Adi Dassler, the inventor of the first shoes designed especially for sports. Until Nike appeared in the 1970s, Adidas had dominated the worldwide market for athletic footwear; at one time, Adidas held 70% of the U.S. market, but by 1990, Adidas’s share had fallen to 2%.

Adidas languished under the control of French businessman Bernard Tapie. A team of American designers was brought in to revitalize the brand image but failed to do so, resulting in a \$100 million loss in 1992. Tapie’s bankers forced him to sell out to Sogedim, a Belgian investment company, in 1993. Robert Louis-Dreyfus, a soccer enthusiast and Harvard MBA, became chairman with an initial investment of \$10,000. He moved all production to low-wage factories in Asia, cut the payroll by two-thirds, hired a former Nike product designer as creative director, and doubled the advertising budget. Although 90% of Adidas products were purchases for streetwear, Louis-Dreyfus was determined to return Adidas to its roots as a sporting goods company; he sold off noncore brands Adidas had developed, including Le Coq Sportif, Arena, and Pony. Finally, he internationalized Adidas’s top management team, appointing an Australian chief financial officer and a Swedish international marketing manager.

After cutting losses in 1993, Adidas became profitable in 1994. The company went public in 1995. The stock price doubled by the end of 1996 as net income approached \$300 million for the year. Industry experts attributed Adidas sales success to two factors. Some fashion trendsetters were bored with Nike and favored the “retro” look of the Adidas three-stripes logo. Other teenage consumers, unfamiliar with the Adidas heritage, saw Adidas as the new young brand on the block.

In September 1997, Adidas announced the acquisition of the French company Salomon for \$1.4 billion. Salomon sold premium-priced ski equipment and Taylor golf clubs (the number two brand in the United States) and held 22% of the ski equipment market worldwide. With the Salomon acquisition, the new Adidas-Salomon Company passed Reebok to become the second-largest sporting goods company in the world.

Adidas sales and share position strengthened throughout 1997. The Adidas order backlog was 58% higher at the end of September 1997 than in 1996. Adidas sold the most athletic footwear in Europe and dominated sales of soccer shoes worldwide. Adidas expected to make further share gains as one of the official sponsors of the 1998 World Cup to be held in France.¹⁰ Nike, however, had already signed 10 international squads and threatened an “ambush” marketing effort to diminish the impact of Adidas’s sponsorship.

The Asia and U.S. markets also remained as challenges for Adidas. Asia accounted for only 10% of Adidas sales. In the United States, Adidas still lagged Reebok as well as Nike, although it passed Fila by increasing U.S. sales 65% in 1997 to \$900 million. Adidas had underestimated the importance of signing up sports stars to endorse a new line of basketball shoes launched in 1996. In

¹⁰ An official World Cup sponsorship cost \$20 million.

the second half of 1997, Adidas set out to boost its U.S. market share through competitive pricing and high-visibility deals such as a \$100 million agreement with the New York Yankees to wear the Adidas logo.¹¹ Adidas's North American sales rose 69% in the third quarter of 1997.

February 1998

On February 24, 1998, Nike announced that continued sales weakness in Asia and excess inventories in the United States and Japan would result in third quarter earnings (for the period ending February 28) between 26 and 28 cents a share versus an expected 38 cents. Analysts expected Nike to lay off 1,500–2,000 of its 9,200 employees and take a \$300 million–\$500 million restructuring charge in its fourth quarter. Some analysts did not expect growth to resume until the end of 1999.¹²

¹¹ Part of the \$100 million payment would be in Adidas stock.

¹² Bill Richards, "Nike Expects Glut, Asian Problems To Hurt Earnings, Force Layoffs," *Wall Street Journal*, February 25, 1998, p. B4.

Exhibit 1 Nike and Reebok Sales and Profit Performance: 1983 to 1997

Year	SALES (\$ millions)		PROFIT AFTER TAX (\$ millions)		RETURN ON EQUITY	
	Nike	Reebok	Nike	Reebok	Nike	Reebok
1983	867	13	57	1	.24	.83
1984	920	66	41	6	.15	.90
1985	946	307	10	39	.04	.44
1986	1069	919	59	132	.19	.44
1987	877	1,389	36	165	.11	.28
1988	1,203	1,786	93	137	.23	.20
1989	1,710	1,822	167	175	.30	.21
1990	2,235	2,159	243	177	.31	.18
1991	3,003	2,735	287	235	.28	.29
1992	3,405	3,022	329	232	.25	.28
1993	3,930	2,894	365	231	.22	.27
1994	3,790	3,280	299	254	.17	.27
1995	4,761	3,482	400	210	.20	.22
1996	6,471	3,479	553	139	0.23	0.36
1997	9,187	3,644	796	134	0.25	0.30 ^a

Source: Compustat, Lexis-Nexis

^aAs of September '97

Exhibit 2 U.S. Stock Price Trends for Three Sporting Goods Companies