BUSINESS

Inside Nike's Struggle to Balance Cost and Worker Safety in Bangladesh

Executives Were Divided Amid Debate Over Controlling Costs, Maintaining Safe Working Conditions

By SHELLY BANJO

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Shelly Banjo has an inside look at Nike's long struggle to cut costs while avoiding workplace disasters in developing countries. Photo: Getty.

DHAKA, Bangladesh— Hannah Jones, Nike Inc. 's head of sustainable business, had been lecturing colleagues for years about the dangers of manufacturing in Bangladesh. Yes, the country featured some of the cheapest factories in the world, she argued, but the athletic-gear maker could ill afford another public pasting over its labor practices.

Her counterparts in the production division, charged with squeezing costs, countered that they should all visit the place together and then decide. So one day last year, five of them slogged up a dirty staircase to the top floors of an eight-story building here that housed one of Nike's suppliers, Lyric Industries.

Rolls of fabric were strewn across the production floor and some windows were bolted shut, Ms. Jones recalls, clear-cut hazards in the event of a fire. The building was filled with other businesses, and there was no telling how safe those were. After spending the morning speaking

Workers assemble shoes in Vietnam in 2005. Nike has labored for years to institute safe labor conditions at its foreign factories. *Associated Press*

with Lyric managers, workers and people in the neighborhood, they flew home and decided to cut ties with the company.

The decision came not long before another garment-manufacturing hub known as [Rana Plaza collapsed], killing 1,100 people in a suburb of Dhaka, in the worst industrial disaster in Bangladesh's history. The tragedy, which happened a year ago this month, has forced Western apparel sellers to re-examine their world-wide search for cheap labor, which has turned Bangladesh into an exporter of $20 billion of clothing a year.

"Our competitors were moving fast into Bangladesh and the pressure was getting bigger and bigger," says Nike Chief Operating Officer Eric Sprunk. "We needed a strong point of view to say, 'Are we going to increase our source base there or not?' "

Nike's internal conflict over Bangladesh shows that its effort to clean up its act in the developing world, which began about 20 years ago, remains a work in progress. As the U.S. apparel industry sends more production to low-cost nations, Nike's experience offers a lesson in the difficulty of managing the twin priorities of controlling costs and maintaining acceptable working conditions.

One faction inside Nike, led by Mr. Sprunk and other manufacturing executives, had argued the company could put the necessary safety controls in place to produce in Bangladesh and better match rivals' cost and margin advantages. But a team led by Ms. Jones, chief sustainability officer, had insisted the company couldn't guarantee working conditions there would be safe.

The decision to cut ties to Lyric Industries, with which Nike had worked for more than a decade, and to another factory reduced Nike's footprint in Bangladesh to four facilities. In effect, it conceded that problems outsourcing production to the country couldn't be easily fixed.

Over the years, Nike's use of overseas manufacturers has periodically sullied its image, and its campaign to eliminate such problems hasn't been easy. It has plowed money into helping factories and sacrificed sales at key moments when standards were breached. It has largely eliminated problems such as factory-worker deaths and the use of certain hazardous chemicals.

But problems persist. The Worker Rights Consortium, a nonprofit group partially funded by universities that monitors factories producing college-athletic gear, has published reports on 16 of Nike's suppliers since 2006 alleging violations of overtime and worker abuse. Last August, the group sent an email to Nike asking why it didn't take action after it was told one of its suppliers in Bangalore, India, didn't raise wages for its 10,000 workers after a government-mandated increase.

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A Nike spokeswoman confirmed the factory failed to comply with wage rules and said workers later were compensated.

"Bangladesh represents a fork in the road for the industry," said Ms. Jones, who is in charge of schooling her co-workers and the company's contractors in factory safety, in an interview at Nike's Beaverton, Ore., headquarters. One direction leads toward the lowest costs, she said, the other toward safer factories.

In the wake of last year's building collapse, Walt Disney Co. pulled its manufacturing out of Bangladesh. But retailers including Wal-Mart Stores Inc., Hennes & Mauritz AB and 170 others chose to stay, signing five-year agreements pledging to draw up safety standards and help fund improvements. Engineers hired by the groups have conducted fire- and building-safety audits on about 700 factories and have pledged to inspect an additional 1,500 by this summer. Nike hasn't participated in those efforts, drawing criticism for not signing a binding safety agreement. Ms. Jones says Bangladesh isn't the company's fight. Nike, which posted $25.3 billion in sales in the year ended May 31 and contracts with 744 factories world-wide, says it can better use its resources in countries where it has a bigger footprint.

A Pakistani boy stitches Nike soccer balls in 1996. Life magazine's use of one such photo brought complaints. *Marie Dorigny/REA/Redux*

Nike was founded in 1964, in part on the premise that it could produce quality footwear at lower costs by using cheap labor at overseas factories—an idea founder Phil Knight came up with while attending Stanford Business School. At the time, only 4% of U.S. footwear was imported. Today, the figure is 98%.

Nike grew rapidly by producing footwear at lower costs and using high-profile endorsement deals to boost sales.

By the 1990s, conditions at the foreign factories making Nike gear had become an issue, making the company a target of protests about the perils of globalization. Mr. Knight and other top executives initially took the position that because it didn't own the factories, it wasn't responsible for safety problems or labor conditions, according to current and former executives.

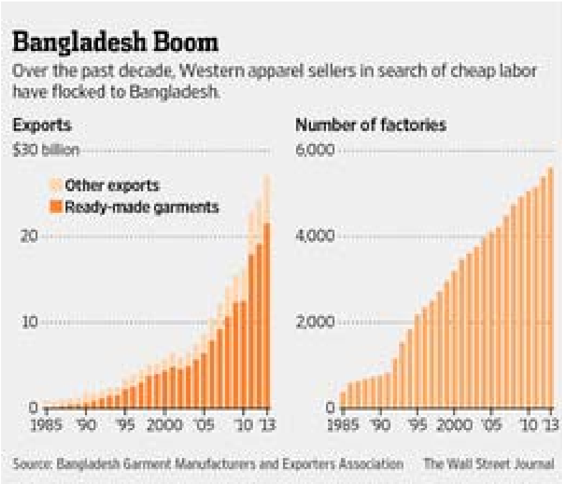
The Nike spokeswoman declined to make Mr. Knight available for an interview, but Chief Executive Mark Parker conceded that Nike's initial reaction to criticism of its contract factories was flawed.

"Ignorance is not bliss," says Mr. Parker. "You have to understand the systemic issues and work with factory partners to solve them."

The company eventually revised its factory code of conduct and hired auditing firms to conduct safety inspections. At the time, Nike mainly left it to the factories to make their own upgrades while it shifted orders among hundreds of facilities and pitted owners against one another in search of rock-bottom prices.

The issue came to a head in 1996, when Life magazine published a story titled "Six Cents an

Hour," with a photo of a boy sewing Nike soccer balls. Mr. Knight groused privately that the scene was staged because soccer balls are stitched and shipped deflated and the balls on the cover were inflated, former Nike executives say.



Some at the company worried its brand would be permanently damaged. Soon after the story came out, appearances by Nike executives at high schools and colleges drew protests. Those incidents prompted a meeting where a half dozen executives pleaded with Mr. Knight to publicly acknowledge a labor problem.

At one point, a manufacturing executive wrote a multimillion-dollar figure on a piece of paper and told Mr. Knight that was how much Nike stood to lose through brand erosion, according to people at the meeting. The Nike spokeswoman says Mr. Knight disputes that such a meeting took place.

Two years later, the CEO vowed in a speech in Washington to root out child labor.

"The Nike product has become synonymous with slave wages, forced overtime and arbitrary abuse," he said.

Nike released the names and locations of its factories—the first major retailer to do so—to be more transparent about its supply chain. It improved air quality for workers by using water-based glue instead of petroleum-based adhesives to attach the soles of its shoes. It stationed dozens of people in countries where it manufactured products and worked more closely with its factories to find cost savings and improve worker treatment.

In 2005, a wildcat strike by 13,000 workers at Chang Shin Vietnam Co., a Nike footwear factory in Vietnam, caused Nike to lose four days of production and the factory to pay added costs to ship items to the U.S. by air. The Vietnamese workers were seeking higher pay.

"It was a tense situation," says Mr. Sprunk, Nike's COO. The strike ended when the factory agreed to a wage increase, hired new management and allowed a full-time trade-union representative.

By 2005, Nike had begun to garner praise from the same activists that earlier had railed against it.

But weeks before Nike's soccer balls were set to arrive in stores for the 2006 World Cup, inspectors at rival Adidas AG presented Nike with photos showing Pakistani children stitching Nike soccer balls, according to a former Nike executive—the same problem that had shamed the company a decade earlier. The Nike spokeswoman said a nongovernmental organization originally flagged the issue.

Nike had worked for years with its main soccer-ball factory, Saga Sports, to root out production at private homes, a practice linked to child labor. But the owner of the factory had died, leaving the operation to other family members. Overwhelmed with orders for the World Cup, the new owners sent the soccer balls to be made at local homes, Nike says. Saga couldn't be reached for comment.

Nike production executives presented the bad news to the board of directors: Soccer balls with a retail value of $100 million would have to be pulled, and it would take 18 months to resume normal production, people who attended the meeting say. Some executives balked, but ultimately management agreed to pull production, these people say.

"It sent a strong signal to our source base and Nike that we were going to put our money where our mouth was," says Mr. Sprunk, Nike's COO.

After Nike officials last year visited a Bangladesh factory run by Lyric Industries, they decided to cut ties to that company. *Shelly Banjo/The Wall Street Journal*

Following the 2008 recession, rising prices for cotton, oil and labor put pressure on Nike's profit. Mr. Sprunk sent seasonal targets for gross margins to each business unit.

At one point, Mr. Sprunk recalls, employees took apart a competitor's fleece jacket to learn how it undercut Nike by $10. After ruling out materials, design and other costs, the team found the answer on the label: Made in Bangladesh.

While the manufacturing team was looking to Bangladesh as an answer to margin pressure, Ms. Jones's safety team was moving in the opposite direction. Her group had hired an outside consultant to create a "country risk index" to score the potential downside of doing business in certain locations. Bangladesh ranked near the bottom, she says.

Nike, which first used a factory in Bangladesh in 1991, had kept its footprint there small, never working with more than 10 factories.

The rest of the industry moved more aggressively into Bangladesh. The 2005 expiration of the Multi-Fiber Agreement had ended an international trade-quota system and prompted retailers to flock to the country.

By 2012, the value of clothing exports from Bangladesh had climbed to $19 billion, double their level six years earlier, and the number of garment factories soared past 5,400, according to the Bangladesh Garment Manufacturers and Exporters Association.

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Nike issued a statement supporting its FuelBand, but challenges remain overall in the wearables sector. Macquarie sportswear analyst Laurent Vasilescu discusses on the News Hub. Photo: Getty Images.

Nike's manufacturing employees advocated going deeper into Bangladesh, arguing they could scout responsible factory owners to manage production safely.

"We faced a decision," Ms. Jones says. "There was a lot of pressure to say, 'Let's go into Bangladesh like everyone else and get great margins and low costs.' So we went through this discussion and looked at the risk index and said, 'We're not going to do that.' "

Mr. Sprunk recalls what happened differently. "We didn't say that," he says. "Hannah said that, and I said, 'Can we talk about this decision?' "

The two executives, who both report to the CEO, decided that members of both the corporate responsibility and production teams would have to fly to Bangladesh together to see factories and make a joint decision.

In January 2013, two months after a deadly fire at a Dhaka garment company killed 112 workers, Ms. Jones set off on a four-day trip to the country with Nick Athanasakos, vice president of global sourcing and manufacturing, and Sharla Settlemier, vice president of sustainable manufacturing and sourcing, meeting two other Nike employees stationed in Asia.

"They had to go together," says Mr. Sprunk, "because if Hannah came back and said we couldn't do it there, the manufacturing guys would be unconvinced, and if only Nick went, there would still be doubts."

They visited the Lyric Industries factory near the end. Like many in the country, the plant was in a multistory, multiuse building that would be hard to make safe. The executives ticked off a checklist of code-of-conduct violations, including excess fabric that could catch fire and barred windows.

"It was fairly evident when they got home what was going to happen next," says Mr. Sprunk. They met with the chief executive and others to explain their decision.

WSJ Radio

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Nike ended its relationship with Lyric after its pending production orders were filled last July. It decided it would stick with four other factories in modern buildings in Bangladesh's export-processing zones.

The decision came against a backdrop of shrinking profitability—Nike's gross margins fell to 43.6% last fiscal year, from 46.4% three years earlier, and remained below those of competitors such as Adidas.

"Did we pass up on margin because of that?" Ms. Jones says. "Absolutely."

Lyric Industries Managing Director Imrul Anwar Liton says his factory did everything requested by Nike on compliance. He says Lyric isn't concerned by Nike's departure and quickly found another buyer.

Days after workers at Lyric Industries sewed their last Nike track suits, managers ripped posters of the company's codes of conduct off the walls. To produce goods for its new buyer, a small Japanese retailer with profit margins half of Nike's, the factory had to double its overtime hours, a Lyric Industries manager says.

"They want their clothes on time no matter what," general manager Sakr Rahman said in an interview at the factory. "We had to tell the workers that the new buyer has a new mind-set, and that means different rules."

—Patrick Barta and Ben Otto contributed to this article.

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