

MANAGEMENT DISCUSSION & STRATEGY

COMPANY STRATEGY AND CORPORATE RESPONSIBILITY

Nike's overall corporate strategy focuses on delivering value to shareholders, consumers, suppliers, employees and the community. We can achieve this by continuing to focus on our mission: To bring inspiration and innovation to every athlete in the world. And according to Nike co-founder Bill Bowerman, if you have a body, you are an athlete.

To this end, we as a company have been building our capability to

- Deepen our relationship with consumers
- Deliver superior, innovative products to the marketplace
- Make our supply chain a competitive advantage, through discipline and excellence
- Accelerate growth through focused execution

In each case, we see that corporate responsibility dovetails with these larger corporate goals:

- Building trust around our corporate responsibility initiatives can increase loyalty among existing customers, rebuild trust with old ones, and introduce us to new communities.
- As noted in the *Environment* section of this report, our focus on sustainable product innovation is slowly becoming evident on retail shelves. Over time, we'll consider how we engage customers about the new value embedded in these products.
- Understanding the complexities of environmental and social issues is key to supply chain excellence.

The *Workers in Contract Factories* section of this report will show that we are gaining a better understanding of the issues we face in this arena. Although we have seen progress over the years, there is still need for improvement. And we will only see significant improvements within the global apparel and footwear industry when market forces reward corporate responsibility and good working conditions are seen as a key indicator of manufacturing excellence.

- Focused execution is best achieved not in isolated pockets, but across the board. We believe we will improve other business systems by improving our systems in corporate responsibility. And, although not proven, a strong corporate responsibility program is an indicator of strong overall corporate management.

Corporate Responsibility Strategy

As we work to support Nike's overall corporate strategy, our approach to corporate responsibility follows a set of clearly identified steps:

- Understand **issues and impacts**
- Set long-term **strategy** and targets
- Drive **business integration** and align incentives
- Drive industry change through **multi-stakeholder partnerships**
- Measure **performance**

Management Discussion & Strategy

We have attempted to structure this report – specifically the sections on *Workers in Contract Factories, Employees and Diversity, Environment* and *Community* – to demonstrate what we have done within each of these steps.

Understand Issues and Impacts

We start with the work of understanding our issues and impacts. This helps us focus and prioritize our efforts. Not only are we finding that this process is best undertaken with rigor, but we're also discovering it is best undertaken in consultation with others, because both internal and external stakeholders help us gain new insights and understand the perspectives of others.

Discussion of impact leads to understanding which strategies and tools will bring about positive change. It involves analysis of root causes and an in-depth understanding of business models. It demands that we engage with government, civil society and other businesses already active in the arena to benefit from their understanding of the issues and impacts. It calls on us to be inventive, innovative and to challenge our assumptions.

It is the first step in an iterative process as our issues and impacts – and our understanding of them – evolve. This notion of constant change sets the tone for the remaining steps.

In performing our self-assessment across the breadth of corporate responsibility efforts, we have gained a fuller understanding of our impacts and the issues we face as a business.

We also recognize that we need to do more work to understand the overall global corporate responsibility impacts of our business. Research is frequently regional or product specific, and no centralized mechanism for sharing this information currently exists.

Set Long-Term Corporate Responsibility Goals

Based on our understanding of our issues and impacts, we set three goals that reflect where we believe we can have the greatest effect on our business and on the world around us.

Our three corporate responsibility goals include the following:

- To effect positive, systemic change in working conditions within the footwear, apparel and equipment industries
- To create innovative and sustainable products
- To use sport as a tool for positive social change, and campaigning to turn sport and physical activity into a fundamental right for every young person.

These are long-term aspirations. Putting them in writing should not suggest we're close to accomplishing them; it instead shows how far we must travel.

Over the past decade we have primarily focused on compliance-related issues, and often in a state of continuous crisis. In regards to the environment and community, innovations have continued to emerge from across the company, but often without the benefit of a comprehensive and coordinated plan. Therefore setting focused, strategic goals is new to our team as well as a key challenge for us going forward.

In setting three corporate responsibility goals for the company, we know we must focus even if that means letting go of good programs currently in existence.

Drive Business Integration and Align Incentives

Within Nike, work often unfolds in silos – with business units sharing information vertically within their unit, but not horizontally across the company. Social and environmental expertise is often confined within our corporate responsibility team. In the past, a degree of separation has existed between CR and the rest of the company.

While product teams are aware of our corporate responsibility goals and support them, their performance is judged in ways that have little to do with corporate responsibility. For example, if a product team misses cost estimates, they hear about it from managers who want to know why it happened or what can be learned from the experience. If the same product team selects factories with low compliance scores, our CR team would hear about it, but the business unit might not be aware of the problem.

The steps we're taking to change this are a central component to our long-term strategy for FY05 and beyond. We will focus on integrating CR into strategic plans and building accountability for our CR objectives.

Drive Multi-Stakeholder Partnerships and Industry Change

From our early years up to the 1990s, the stakeholders we thought most about were athletes and consumers. In the 1990s, we ignored an emerging group of stakeholders. We learned a hard lesson.

Today, engagement with stakeholders (anyone affected by, or affecting, our business operations) is increasingly important to Nike. They help us to prioritize key issues and develop and implement our CR policies. We've learned a great deal from this interaction. Non-governmental organizations (NGOs), trade unions and others have opened our eyes to new issues and viewpoints, and have enabled us to draw on their experience and expertise. This does not mean that we will always agree with our stakeholders, but we know from experience that constructive engagement is usually the approach that brings about the best insight to the challenges we all have an interest in addressing.

But consultation with stakeholders is only part of the value of engagement. The industry is at a crossroads, and individual companies are limited in what they can achieve acting independently.

Nike may be a prominent brand, but we account for under two percent of the global \$800 billion footwear and apparel industry. We contract with factories employing an estimated 650,000 workers, compared to an estimated 50 million workers worldwide. Because we're the number one footwear brand, we sit at the top of the industry pyramid, working with the top suppliers. So the issues we see in our contract factories are not only indicative of greater issues across the industry, but, given our rigorous screening process, we suspect the issues are more pervasive.

That is why we believe disclosing our contract manufacturing base has the potential to open the door to a deeper level of collaboration with our stakeholders in addressing our industry's most material issue – working conditions in manufacturing facilities.

Even though we're working hard with our suppliers and looking back into our own business processes to create mechanisms that enable corporate responsibility, it's only when market forces enable corporate responsibility that widespread change will occur.

So what could happen in a world where supplier data is openly shared?

This disclosure should enable brands to share information about compliance performance and minimize duplication of efforts. Lowering the price of entry into corporate responsibility means that more can and must join and commit.

Management Discussion & Strategy

In turn, monitoring becomes a less cumbersome process for suppliers. There is also an increased incentive to be proactive, which allows those suppliers investing in corporate responsibility to use it as a part of their proposition to other buyers. Monitoring also becomes optimized allowing brands to shift resources to capacity building.

All of this should support efforts to move to common standards, greater collaboration and greater transparency, which in turn supports the development of a marketplace where responsibility and competitiveness go hand-in-hand.

Measure Performance

For each goal, we plan to establish targets and timelines to gauge progress. Some of these are noted in subsequent sections of this report and others we are still in the process of defining.

This is an area where a great deal more work is needed. As a globally dispersed team, it has been difficult to set global targets, and even harder to measure performance against them. You will find that targets and concrete measurements of performance are missing; developing these are a key objective for our team in FY05 and FY06.

Because data is usually quantifiable and comparable, measuring performance for much of our environmental work is relatively straightforward, but demonstrating measurable performance for working conditions within our contract factories is more difficult. We do not feel that audit results are a useful measure of progress, but a broad indicator of where problems lie. We have evidence of success in pockets, but without comparative measures over a series of years, it

remains anecdotal. Identifying the appropriate metrics and tracking progress will be a major task for the years to come, which we plan to pursue through multi-stakeholder initiatives, including the Global Reporting Initiative (GRI) reporting sector supplement initiative.

With our community investments, measurement is also challenging. For most of the programs we support, we tend to track the number of grants, programs or dollars, but these metrics don't answer the key question: Did they have an impact on a young person's life? For some of our projects, including those covering NikeGO in the United States and our programs in the EMEA region, we have pioneered impact assessment methodologies. For our other community affairs programs, the goal is to shift from measuring how much we give to measuring the real impact of the investments.

We realize that while we have a great deal of information to report, we still need to identify key indicators that we will use to set interim and medium-term targets for measuring our performance.

We will be seeking out others to join us in disclosing supply chains, and engaging with trade unions, civil society and government bodies to consider how disclosure can unlock collaboration.

So while we have much work to do internally to address our corporate responsibility challenges, we do not believe Nike has the power to single-handedly solve the issues at stake. This will only come through working with others in the industry through a variety of multi-stakeholder partnerships. And this is true for all areas of corporate responsibility, from compliance and environment to community investment programs.

Stakeholder Engagement

Nike's direct stakeholders include consumers, employees, investors, governments, retailers, athletes and athletic associations, suppliers and workers in our supply chain. Indirect stakeholders include academics, the media, trade unions and NGOs.

In addition, we have relationships with a large number of external groups. In order to have effective, quality engagements, we must prioritize and become more selective about groups with whom we will engage. For this reason, we focus on stakeholders with some of the following characteristics:

- **Legitimacy:** They have a direct stake in an issue, or there is a general public perception that they should be at the table.
- **Networked:** They are part of extensive networks and can bring perspectives from large numbers of stakeholders around a particular issue or within a particular region.
- **Expertise, resources and capabilities:** They have specific knowledge, resources or capabilities that can help us understand and address corporate responsibility challenges and opportunities.
- **Willingness to engage constructively.**

Approaches to Engagement

Different stakeholders require different engagement methods. We take a portfolio approach to stakeholder engagement with multiple approaches and varied levels of investment. This approach enables us to reach a larger number of stakeholders, investing more deeply with those that are more directly linked to our business. Examples of our stakeholder partners are listed throughout this report. The different forms of engagement include:

Report/Inform	Consult/Involve	Support	Multi-Stakeholder Partnerships
Provide information for stakeholders in a range of ways to update them on our progress (e.g., CR Report, website, e-newsletters, participation in socially responsible investor [SRI] surveys).	Seek input and guidance from external stakeholders to understand diverse perspectives (e.g., stakeholder forums, informal one-on-one meetings, surveys, etc.).	Provide support in the form of endorsements (e.g., for the GRI or Global Compact principles) or practical/philanthropic (e.g., community activities and programs).	Participate in coalitions, partnerships, projects, etc. for leverage purposes (many can usually accomplish more than one) or to access the knowledge, resources and experience needed to tackle issues effectively.

For a discussion of the challenges we have identified through stakeholder engagement, see the *Challenges and Opportunities* section of this report.

Management Discussion & Strategy

LEARNING FROM STAKEHOLDERS: NIKE'S FY04 STAKEHOLDER FORUM

We held our first global Stakeholder Forum in February 2004. Approximately 70 people took part in this two-day event, including 30 Nike employees and representatives from environmental and worker rights NGOs, trade unions, investors and suppliers. We could not include all of our stakeholders, but tried to include a diverse, representative group. Stakeholders were invited on the basis of their history of constructive engagement with Nike or their expertise on a particular topic. While the forum allowed for a broad discussion of Nike's CR strategy and goals, we also focused in-depth discussion around key emerging issues (China, women in the supply chain and MFA) that might best be addressed through a multi-stakeholder network approach.

Participants were asked for their views on our CR plan and to identify what they regard as the most important CR issues for Nike. Their feedback emphasized the following:

- CR issues must be integrated into Nike's core business strategies, with transparency on how this is being done. Participants also wanted to see more specific and measurable CR goals, particularly on social issues.
- Labor issues are an important priority for Nike's CR program and an area where stakeholders would like more information. Stakeholders recognized that Nike had made a good start at addressing labor practices in contract factories but wanted to see further progress. They identified freedom of association as a key issue, expressing concern about the challenge of adequate worker representation in countries such as China. They also identified phase-out of the Multi-Fiber Arrangement (MFA) as a key issue.
- Many participants highlighted support of women and girls in developing countries as a good opportunity for Nike to help bring about positive change. This included advocacy of women's rights on issues such as education and maternity leave, and a particular focus on the unique needs of adolescent girls.
- Environmental discussions focused on the specific challenges of China, types of materials used in Nike products, and concerns about water scarcity. There was positive feedback on Nike's goal of waste and toxics elimination.

Feedback from the forum is helping us prioritize our CR efforts. For example, the discussion led to the formation of the Multi-Fiber Arrangement forum (MFA forum), a multi-stakeholder group looking at ways to further understand and explore options to ease the impacts of MFA phase-out on workers and communities. (See *Challenges and Opportunities* section.)

Responsiveness

We are working on developing systems to enhance Nike's responsiveness to stakeholders with whom we are actively engaged. To this end, SustainAbility, a UK-based research, advocacy and consultancy company, completed an assessment of all the feedback we have received from stakeholders in the past several years. To read this assessment, please see our website at <http://www.nikeresponsibility.com/reports>.

We intend to continue seeking direct feedback from stakeholders, but we are exploring ways this might be achieved through existing networks or in conjunction with other companies to reduce the burden on stakeholders and ourselves.