

Ties That Bind: Case Study

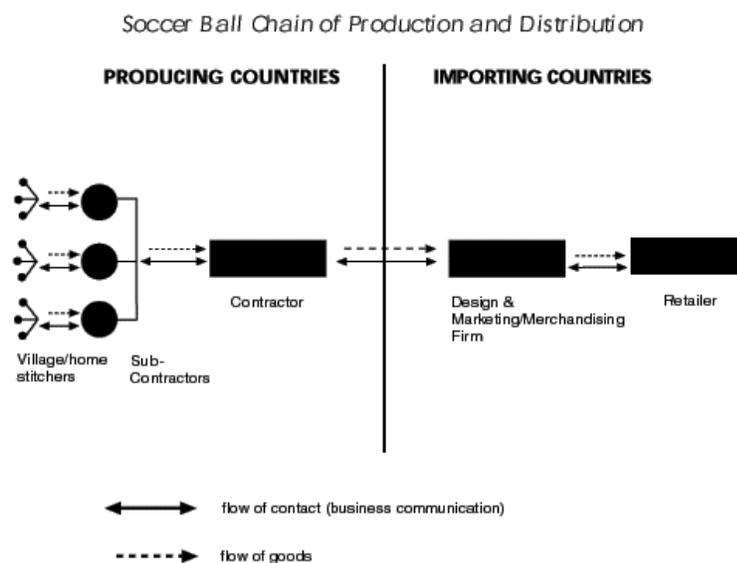
Pakistan Sporting Goods – Saga Sports and Nike

This case outlines the relationship between a Pakistan sporting goods manufacturer, Saga Sports and Nike. The case will illustrate how doing business with international brands requires an integration of processes and full adoption of international standards. Specifically, the case will explore the importance of institutionalized processes within the supplier and the need for the supplier to internalize the brand equity of its buyer and uphold end-market standards. The case will explore the difficulties of monitoring and enforcing production standards in cottage industries.

Origins and Nature of the Buyer-Supplier Relationship

Sialkot is the soccer ball capital of the world. At its height in the mid-1990s, nearly 80% of the world's soccer balls were stamped with “made in Pakistan” and were, in fact, made in Sialkot. All of the major brands had operations in Sialkot including Nike, Adidas and Puma. Up until that time, the industry functioned as a cottage industry. The production was managed in the city of Sialkot where the main factories would print and cut the material. The material was then given

to subcontractors who would serve as an intermediary to villages and homes, delivering the materials and paying the homes on a per piece basis. The subcontractors would then return the balls to the Pakistani contractor to be packed and shipped. The industry structure took advantage of the widely available cheap labor – representing an estimated 40,000 workers, but also was vulnerable to child labor practices.



Source: US Department of Labor, 2007. www.dol.gov/ilab

European Championship. While the allegations extended across all the brands, the Nike brand was pictured in the Life expose. This occurred at the same time as other allegations of labor violations in other countries for Nike.

In response to the violations, Nike, and the other brands, worked with the international community and the local suppliers to set in place an institutional structure and manufacturing process to prevent any further violations in international labor standards. From these efforts, an international agreement, known as the Atlanta Agreement was signed and a revised structure

and management system for the production of soccer balls in Sialkot was adopted. The Atlanta Agreement established a voluntary prevention and monitoring program with four key elements:

1. Registration of contractors, stitchers and stitching facilities
2. Establishment of internal monitoring systems
3. Agreement to independent monitoring
4. Coordination with a social protection program for children

The founder of Saga Sports, Mr. Khurshid A. Soofi, served as the Chairman on the standing committee for child labor and led the development of the Atlanta Agreement. Both Nike and Saga were signatories on the agreement and adopted the conditions of the agreement in the production process. In 2001, Mr. Soofi died and there was a shift in the direct management of Saga.

In parallel, the structure of the soccer ball industry has been shifting. For the first time, in 2006, the official ball of the World Cup was not hand-stitched. The balls, made in Thailand, were instead melded together using a new thermal technology. Introduction of stitching technology to the production system coupled with an increased competition from outside Pakistan has led to cost pressures on the traditional Sialkot producers. The expectation is that in near future only the very premium soccer balls will be hand-stitched. Competition is increasing across Asia in soccer ball manufacturing. The Pakistan producers have yet to make the required investments to keep up with the shift in the market.

Earlier this year, Nike received indications that labor violations were again occurring and commissioned an international non-profit to conduct an investigative report that found conclusive evidence of violations. Over the past six months, extensive mediation occurred between Nike and SAGA which included the direct involvement of Nike global executive leadership team. The mediation did not produce credible results on the correction of the violations. Unable to risk a renewed assault on its brand equity, Nike canceled the contract.

Role of Outside Support / Facilitation

To date, outside support to the sporting goods industry in Pakistan has been limited to directly addressing the issue of child labor. The International Labor Organization, United Nations, and numerous human rights organizations have played a role since the subject came to light in the 1990s. The focus of the support has been in the areas of:

- Mediation and negotiation
- Monitoring of international standards
- Capacity-building
- Social support to the stitching communities

Under the Atlanta agreement, originally the ILO was responsible for the monitoring. However, the ILO turned the IMAC program over to the Sialkot Chamber of Commerce in the first few years with only a limited amount of spot checking by either the ILO or the industry.

Costs and Benefits of the Buyer-Supplier Relationship

The incidence of child labor, the innovation in production technology and the shift in the market are all contributing to a change in the buyer-supplier relationships in the sporting goods industry in Sialkot.

Previously, commercial relationships in soccer ball manufacturing were based on abundant, low cost labor and a flexible, efficient production system. Nike, and the other brands, benefited from

the Sialkot producers ability to deliver consistency and quality at a low operating cost, but ultimately at a high social cost and risk to the international brand.

The uncovering of the child labor and the negative tarnish it left on the Nike brand shifted the dynamics of the buyer-supplier relationship with Saga. With the availability of alternative producers in other countries, potentially at lower costs, Nike and the other brands are in a much more mobile position.

The costs of the failed relationship are significant. For Nike, canceling the contract has sacrificed at least 12 months supply of soccer balls to the market, and likely substantially more than that. It has also invested significant management time in mediation with Saga and the community stakeholders. However, the future costs of another assault on the brand equity exceeded the short-term transaction costs of terminating the relationship.

On the supplier side, the costs are weighty, including the loss of contract and future profit, tarnished image within the industry, and job losses estimated between 5,000 and 30,000. For Sialkot, and Pakistan as a whole, the failure of Pakistani businesses to uphold international standards risks tarnishing the image of Pakistan to foreign investors and undermining future investment in the economy.

Strategies for Overcoming Risks

The strategies enacted after the first set of incidents in the 1990s appeared sound and worked for a short period of time. The international agreement, third party mediation, restructuring of production processes, establishment of monitoring systems, and community investment appeared to create a holistic approach to addressing the child labor issue. However, the recurrent of the labor violations indicates that the strategies were not institutionalized within Saga. While the founder of Saga understood and shared the corporate values of Nike, the new leadership may not have adopted those same values and management practices.

The failed relationship begs the question, what else could have been done to prevent the cancellation of the contract?

Lessons Learned

Doing business with international supply chains requires integration of processes and adoption of international standards. Failure to uphold those standards can have significant consequences to the business and the economy. Such failure can also be seized up as an excuse to terminate a relationship and exit a market.

The specific lessons of this case can be summarized as follows:

- The cottage industry structure of the soccer ball stitching supply chain offered Saga Sports a low cost production model. However, the structure ultimately left the supplier, and its buyer, vulnerable to violations of international labor standards.
- Third party verification requires significant time in order for an industry to internalize substantial changes to a production model. Under the Atlanta agreement, originally the ILO was responsible for the monitoring and then it turned the IMAC program over to the Sialkot Chamber of Commerce. There is a general sense among the stakeholders that the transfer happen too soon, without enough spot checking by either the ILO or industry to see if a home-owned model would work.
- Institutionalization of ideals and standards is essential for sustained change. Even after the violations were brought to light, the supplier was unable to institutionalize a

production model and management system to conform to those international standards. When Mr. Soofi died and his key leadership left, so did the ideals. Institutionalization ensures that ideals and standards are not tied to personalities.

- Ultimately, the interests of the supplier, Saga, were not aligned with the interests of the global brand that it was serving. Saga underestimated the risk of compromising Nike's brand equity. When structuring a relationship between a international buyer concerned about brand equity, it is critical to align the interests of the supplier to the value of the brand.