



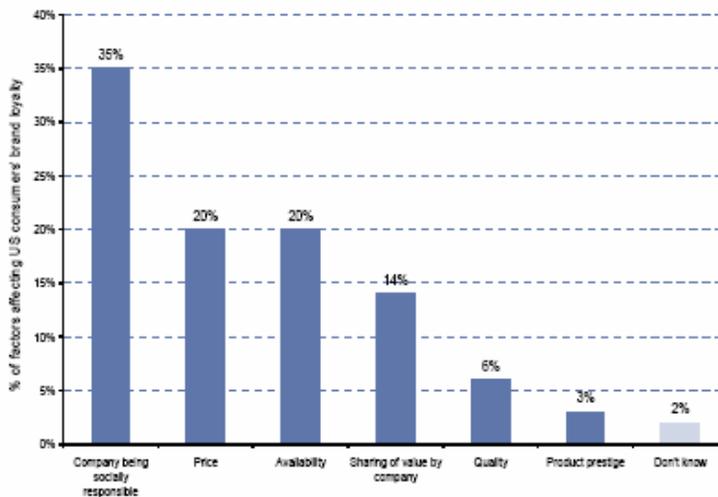
Supply Chain Initiatives: How Supply Chain Perils Impact Brand

Prepared for Whole Foods

Executive Summary

While understanding a supplier's origin or carbon footprint was not a priority for companies a decade ago, supply chain responsibility is now capturing the mindshare of consumers and reporters around the world. A survey of more than 10,000 consumers revealed that corporate social responsibility was the number one determinant of brand loyalty (35%) among Western consumers; price and availability ranked second (each with 20%)¹. As a November 7th *New York Times* article referenced, tackling the supply chain is considered “Phase 3 of the greening of corporate America².” Since 50 percent or more of a product's value is derived from suppliers, corporate social responsibility is intricately linked to the supply chain. Companies and consumers are increasingly more aware that customers do not just buy products; they also buy the supply chains that deliver the products. So what happens to a brand when a supply chain falters? This document explores case studies from two of the world's biggest brand companies - Nike and Mattel - to discuss the impact supply chain disasters have on brand with regard to negative publicity, employee morale, customer loyalty, and financial performance.

Exhibit 21: Factors influencing brand loyalty for Western consumers



¹ Rethinking Corporate Social Responsibility - National Consumers League - Fleishman-Hillard, 2005

² New York Times - November 7, 2007 - *For Suppliers, the Pressure Is On*

A brand is more than the expression of a company's name and logo; a brand is a promise. By identifying and authenticating a product or service, a brand delivers a pledge of satisfaction and quality. In his book, *Building Strong Brands*, David Aaker suggests that a brand is a "mental box" and gives a definition of brand equity as "a set of assets (or liabilities) linked to a brand's name and symbol that adds to (or subtracts from) the value provided by a product or service." As we explore the experiences of Nike and Mattel, we will review the new customer perceptions that now occupy the most valuable real-estate in the world -- the consumer's mind.

MATTEL Case Study: "Unleaded Please"

Mattel, Inc., (NYSE: MAT, www.mattel.com) is the worldwide leader in the design, manufacture and marketing of toys and family products. The Mattel family is comprised of such best-selling brands as Barbie®, Hot Wheels®, Matchbox®, American Girl®, and Fisher-Price® brands. In 2007, Mattel issued eleven product recalls, equaling all of the product recalls for the previous four years (2003 -- 2006). The voluntary product recall issued in August 2007 was initially attributed to a contract manufacturer in China who was producing toys with non-approved paint pigment containing lead, "which is in violation of applicable standards, as well as Mattel's own self-imposed standards." After that initial statement, Mattel issued 7 additional product recalls on millions of beloved toys from Barbie® products to Go Diego Go! animal rescue. Mattel recanted their initial statement and instead blamed "a vast majority of the recalls on a design flaw made by Mattel, not on manufacturing problems in China." Whether the supply chain is to blame, or the supply chain management process, it is clear that the recalls have had significant impact on Mattel's brand and perceptions of the customers.

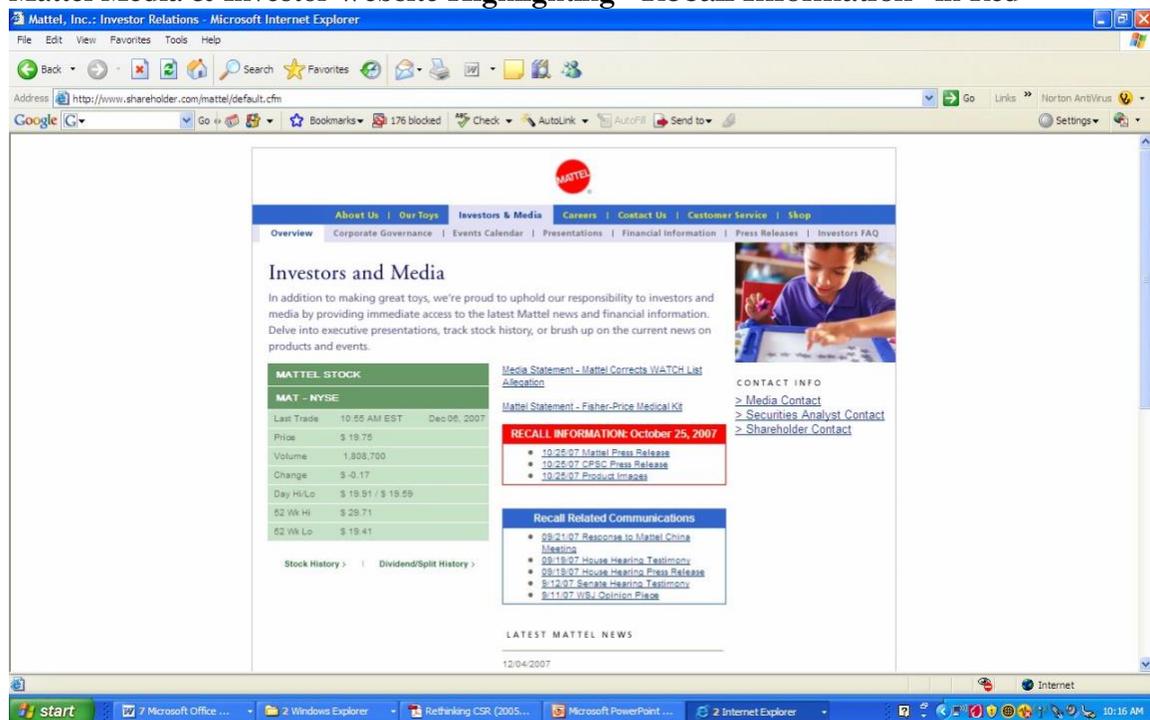


Investments in Countering Negative Publicity

Since the initial product recall in August, news agencies, internet reporters, toy stores, schools and childcare agencies around the globe helped to carry the news of Mattel product recalls in news reports, flyers to parents, and posters. In an effort to save children from potential lead poisoning due to Mattel's Chinese manufacturers, the army of do-gooders were communicating widely and effectively. To counter negative publicity, Mattel invested in a

series of communications and initiatives. Mattel issued five press releases on the recalls and related matters in less than two months. Mattel's CEO testified before the US House of Representatives and the US Senate on toy safety. CEO published an opinion piece in the *Wall Street Journal* to correct inaccurate portrayals of his leadership and the company, and apologize to their customers. The company updated its website making corporate responsibility and product safety prominent on its home page. Consumers can get information about the product recalls in 10 languages and investors can read the latest corporate statements on the product recalls. While not publicly disclosed, there were no doubt thousands of other "emergency communication" tactics employed to reach Mattel's stakeholders -- customers, employees, investors, and suppliers.

Mattel Media & Investor Website Highlighting "Recall Information" in Red



In addition to communications efforts, Mattel made significant organizational changes to reflect the importance of product safety. Within 40 days of the news of "lead paint" Mattel created a new Corporate Responsibility organization reporting directly to the company's Chairman and Chief Executive Officer. While a reactionary move, the new organization was designed to add a new level of accountability to the company's safety and compliance protocols. The new division will be headed by the Senior Vice President of Corporate Responsibility; the organization will include product integrity, global sustainability, environmental health and safety, consumer relations, corporate communications, government relations and the Mattel Children's Foundation. Additionally, Mattel created a new function of Product Integrity Policy & Audit, which has a mandate of functioning as an internal audit organization that will monitor Mattel and vendor facilities' compliance with Mattel's Product Integrity standards.

Impact on the Supply Chain

Mattel manufactures millions of toys in China. Keeping China's perception of Mattel strong is critical to Mattel's ongoing profitability. In an unprecedented move, Mattel made a public apology to the Chinese government for misstatements about the contract manufacturer in China. China's head of product safety responded indicting Mattel for poor control measures and inappropriate broad sweeping claims. In addition, China took the opportunity to remind Mattel that the country's low-cost supplier position enabled Mattel to enjoy strong profits. While not publicized, it is likely that Mattel's entire supply chain was affected by this incident, potentially reducing Mattel's buying power, and increasing their costs.

Competition Poised to Steal Market Share

With just four months of the scandal, it is too early to assess whether Mattel is winning or losing market share. However, the incident has provided competitors with an easy target. To kick-off the Holiday shopping season,

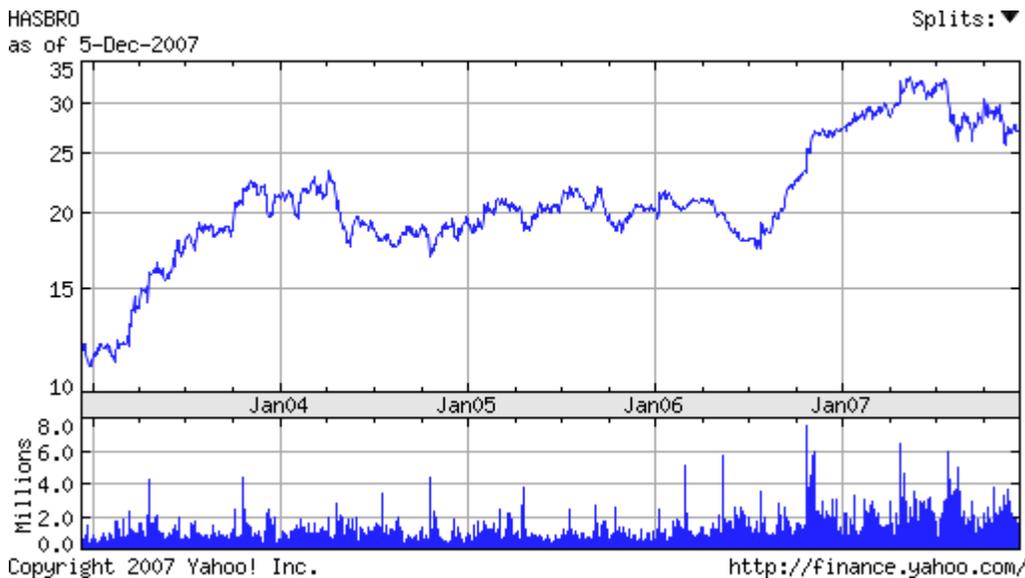
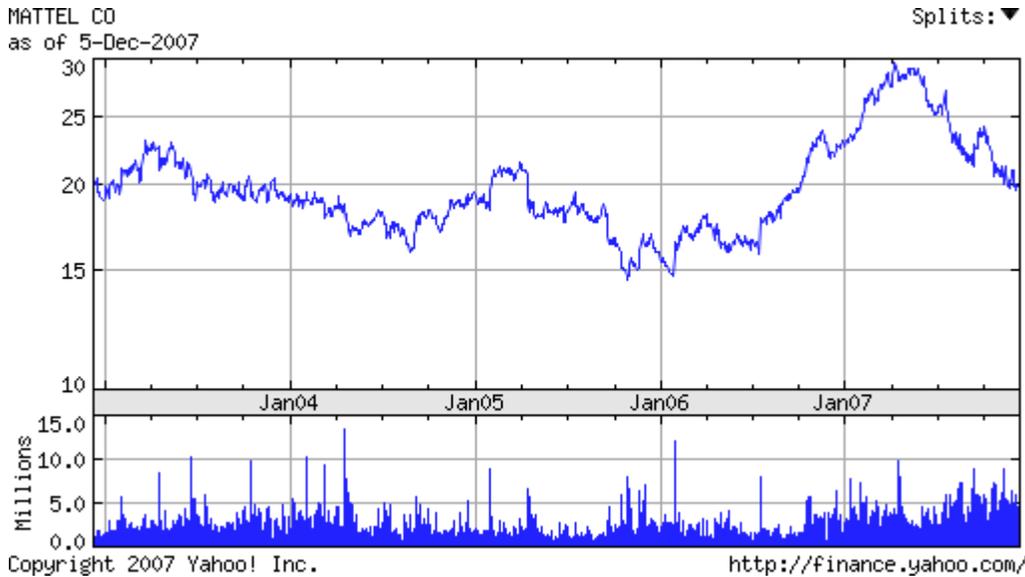
leading competitor and the world's second-largest toy company - Hasbro - issued a series statements and newspaper ads claiming "lead free toys." The message indicates that Hasbro has had no recalls for lead or other dangerous chemicals, and people can feel good about buying Hasbro toys and games. Hasbro Chief Executive Alfred J. Verrecchia took the opportunity to compare its supply chain practices to Mattel's. *"Our standards meet or, certainly in the lead paint case, exceed the federal standards, and we have a very robust testing and inspection process in place to ensure that those standards are being adhered to. We believe that's why we've avoided the recalls."*



A smiling Hasbro CEO seeks to reassure "parents and caregivers."

Financial Impact

It is difficult to put a price tag on the effect the product recall incident has had on Mattel's financial performance. The long-term financial impact of customer loyalty, brand erosion, supply chain costs, and employee morale may not be fully tallied. However, in the third quarter results report issued just nine weeks after the lead recalls began, the company attributed incremental costs of approximately \$40 million related to the company's product recalls during 2007. While the company has achieved record performance in 2007, compared to the prior 4 years, the stock is hovering around its 52 week low of \$19.41 a share, compared to the 52-week high of \$29.71. The biggest competitor, Hasbro, is hovering around \$26.68, with a 52-week high of \$33.49.



Is the Brand Permanently Damaged?

While it may be too early to assess the full impact of the product recall scandals on Mattel's parent brand and sub-brands, it is clear that Mattel's reputation in the minds of its customers, shareholders, and employees has been damaged. In two separate statements, Mattel executives confirm that the product recalls have impacted the company's brand. In a statement issued approximately one month after the initial recall, Mattel vice president Thomas Debrowski said, "Our reputation has been damaged lately by these recalls. And Mattel takes full responsibility for these recalls and apologizes personally to you, the Chinese people, and all of our customers who received the toys." At approximately the same time, the CEO Bob Eckert participated in a series of public statements. Below is an excerpt from his opinion piece featured in the Wall Street Journal, where he highlights the feedback he has received from customers, employees, and his own children.



A MESSAGE FROM BOB ECKERT

MATTEL CHAIRMAN & CEO

*What is going on at Mattel? I've heard this question many times over the course of the past few weeks as we've conducted three voluntary recalls of products, due to impermissible levels of lead in paint. **I've heard from concerned parents, employees, my neighbors, former colleagues and even my own children.** I think just about everyone knows we've had recalls. That's good. It means we have achieved our main goal of successfully communicating widely and openly with our many constituents.*

*Media coverage of the recalls, overall, has been helpful in spreading the news to consumers. Unfortunately, in some cases, opinions have been attributed to me that I've never held, let alone expressed. **More seriously, the character of Mattel has been maligned.** We've even been accused of being "unapologetic" by the very same newspaper in which we ran full-page ads apologizing. I apologize again.*

The chief irony is that Mattel's product recall incident has overshadowed all the good actions it has taken in the same year in the field of corporate social responsibility. In 2007 Mattel issued its second corporate responsibility report, and is still the only toy company to do so. It was the first toy company to conduct independent and public monitoring of its manufacturing facilities and this year marked the 10-year milestone of its global manufacturing principles. However, the media hasn't covered this and families aren't talking about this as they sift through the toy bins for Diego's animal rescue kit. The question is whether customers will remember Mattel as one of the 100 Most Trustworthy U.S. Companies (Forbes Magazine) or that as a maker of poisonous toys? How long will this memory of the world's premier toy brand last in the minds of the shopper? It depends if it is cast in lead or stone.

NIKE Case Study: "From Swoosh To Sweatshops"

Nike, Inc. (NYSE: NKE, www.nike.com) is the world's leading designer, marketer and distributor of authentic athletic footwear, apparel, equipment and accessories for a wide variety of sports and fitness activities. Nike's subsidiaries include Converse Inc. and Cole Haan Holdings Incorporated. Nike rode a wave of success in the 1990s with its lucrative association with Michael Jordan and its ubiquitous slogan "Just Do It". A key component of Nike's business model was the outsourcing of



inexpensive labor abroad. Allegation of abuses at Nike's Asian factories began brewing in the press in 1989, eventually reaching a fever pitch in 1997. That year, Nike was subject to a

scathing feature on the front page of the *New York Times*, boycotts, campus protests, and cultural ridicule.



Investments in Countering Negative Publicity

Nike was initially dismissive of claims that the company was running “sweatshops”, only fueling the fire of activists and journalists. In 1997, Nike was forced to take action against the negative publicity surrounding its supply chain. An early step for Nike was hiring civil rights activist Andrew Young to conduct an independent assessment of Nike’s Code of Conduct. Nike paid for a full-page advertisement in major newspapers in June 1997 to promote the findings from Andrew Young’s report. The advertisements backfired for Nike; critics objected to the report’s methodology, conclusions, and showy format. After the 1997 *New York Times* article, Nike held a press conference to address the sweatshop issues.

In 1998, Nike formed a Corporate Responsibility division and hired experienced staff. Nike also announced six new initiatives to “improve factory working conditions and increase opportunities for people who manufacture Nike Products,” including MESH (Manufacturing Employees Safety and Health) to ensure adherence to best practices in Nike’s factories.

Impact on Employee Morale

Nike employees experienced significant tensions in the wake of the company’s negative publicity. In a 1999 University of Western Ontario business case⁴, Simon Pestridge (Nike’s Labor Practices Manager) noted the following environment amongst Nike employees:

- Nike employees placed in uncomfortable situations amongst peer groups; feeling unable to defend their company’s labor practices.
- Nike employees viewing emotional materials that criticize their company on the internet.
- Nike employees feeling challenged to defend the brand internally and externally.

Pestridge also noticed a dramatic shift while recruiting on college campuses. Instead of aggressively pursuing jobs with Nike, students began questioning Nike’s labor practices.

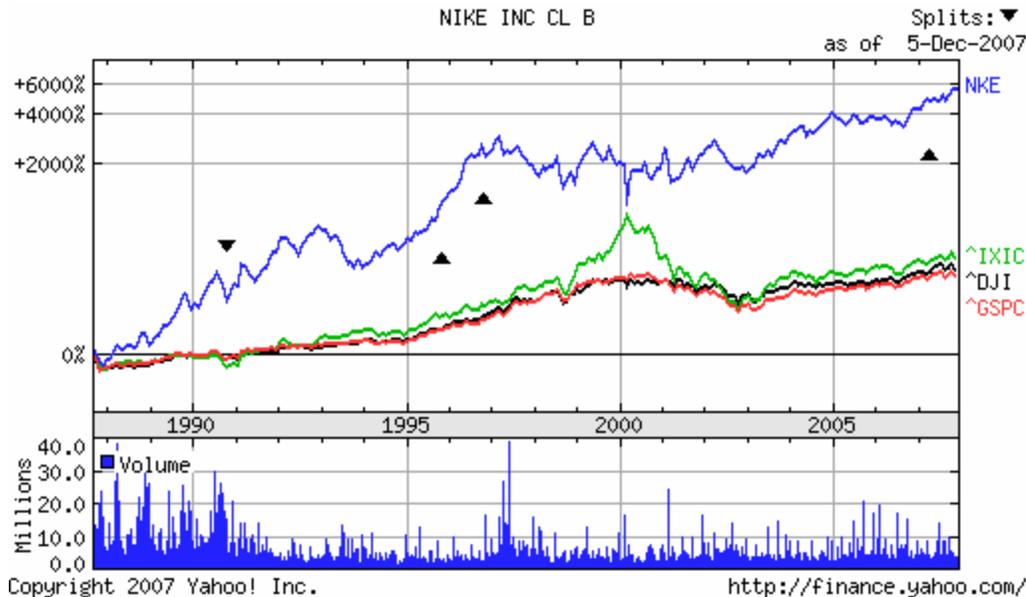
Financial Impact

1998 was a difficult year for Nike financially. Nike reported a loss, which was attributed to changing fashion trends and the Asian financial crisis. Management denied that the sweatshop

³ “Hitting the Wall: Nike and International Labor Practices”, *Harvard Business School*, 2002.

⁴ “Nike Inc.: Developing an Effective PR Strategy”, *University of Western Ontario- Ivey School of Business*, 1999

scandal had impacted the firm’ s financial results. In 1998, Nike’ s market capitalization dropped over 25% in 1998 (from 16.6 billion to 13.2 billion). Nike also lost nearly five percent market share in the global and U.S. footwear markets in 1998. It is difficult to quantify the exact financial impact of Nike’ s sweatshop scandal and the degree of correlation between the scandal and Nike’ s financial troubles in 1998; **Phil Knight did concede the following during a 1998 speech: “the Nike product has become synonymous with slave wages, forced overtime, and arbitrary abuses.”**



Is the Brand Permanently Damaged?

In contrast to Mattel’ s recent supply chain setbacks, we can look to Nike for ten years of historical perspective. At the height of Nike’ s supply chain troubles, management acknowledged a “growing recognition that issues, left unchecked and unanswered, can have a long-term negative connotation.” Does Nike still experience the negative connotation today? Nike recently ranked #29 on Interbrand’ s “Best Global Brands of 2007” List with a brand value of twelve billion (roughly 38% of its market capitalization). Nike has maintained a strong brand, but the scars from its sweatshop scandal have been lasting. Nike Anti-Sweatshop campaigns remain in effect. “Still Waiting For Nike To Do It” headlines the website of Global Exchange, one of the biggest critics of Nike’ s labor practices. Remnants of Nike’ s sweatshop scandal can be



⁵ “Nike Inc.: Developing an Effective PR Strategy”, *University of Western Ontario- Ivey School of Business*, 1999

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found all over the Internet. Google' s search suggestion tool prompts users to search for “Nike sweatshops” based on search popularity; Nike' s Wikipedia page has a section entitled “Human Rights Violations⁷”.

Nike' s public relations disaster was amplified by several factors in the mid-1990s: growing awareness of and discontent with globalization, the onset of the Internet, and Nike' s mammoth role in Western culture. Nike was not only an easy target for activists but also a strategic one to raise awareness about sweatshops. Some have suggested that Nike was targeted based on the “tall poppy tree theory” - a view that tackling the top of the tree will cause the lower branches to fall.

⁷ Nike' s Wikipedia Site: http://en.wikipedia.org/wiki/Nike,_Inc