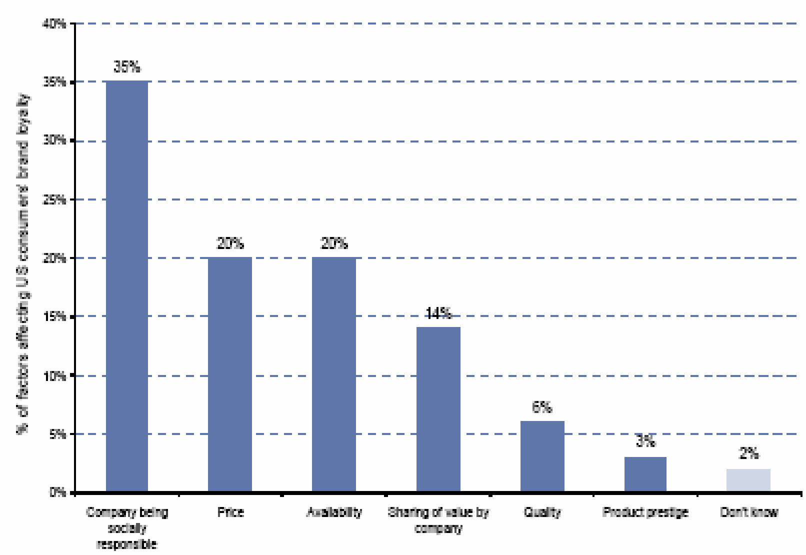
Supply Chain Initiatives:
How Supply Chain Perils Impact Brand

April 8, 2015

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 *New York Times* article referenced, tackling the supply chain is considered "Phase 3 of the greening of corporate America." 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. Finally, a case study of a Global Grocery Retailer will be reviewed to demonstrate CSRG's ability to help clients avert the crises faced by Nike and Mattel.

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.

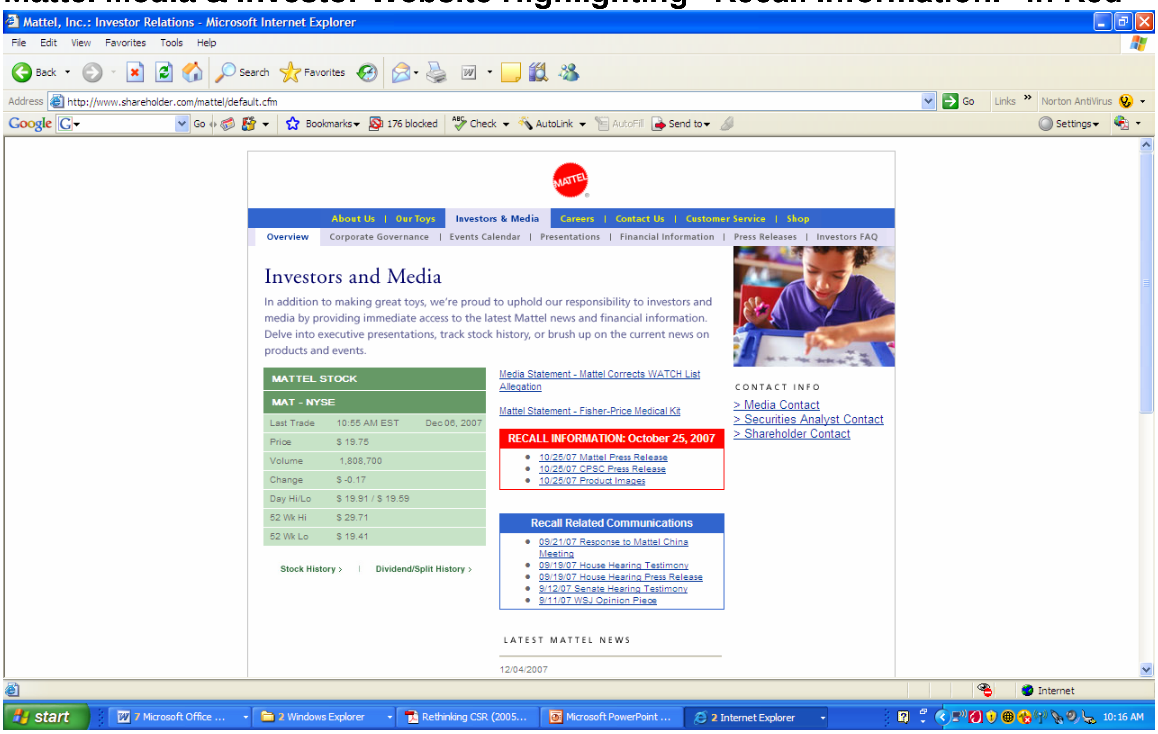
MATTEL Case Study: "Unleaded Please."

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 or 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.

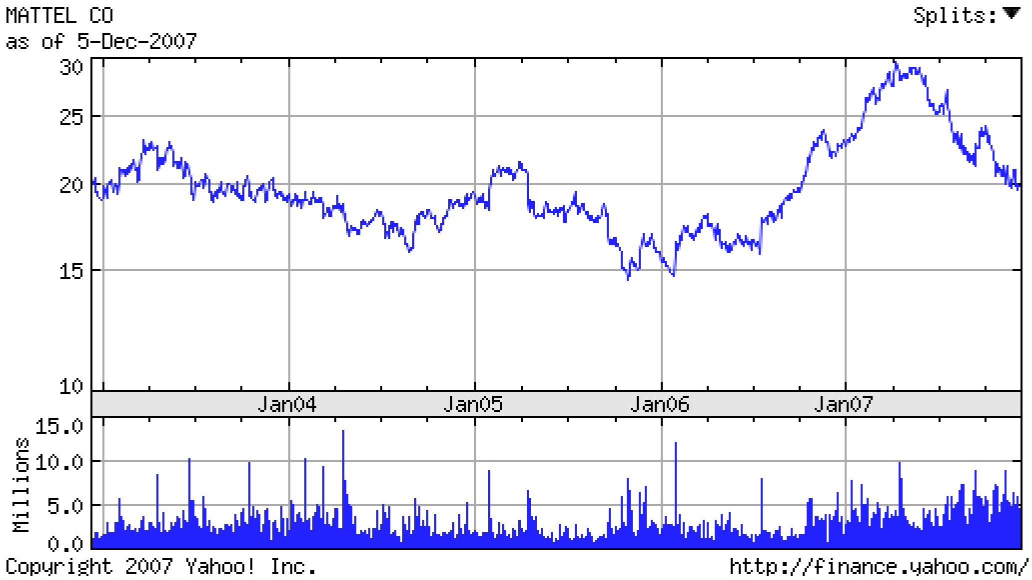
Competition Poised to Steal Market Share

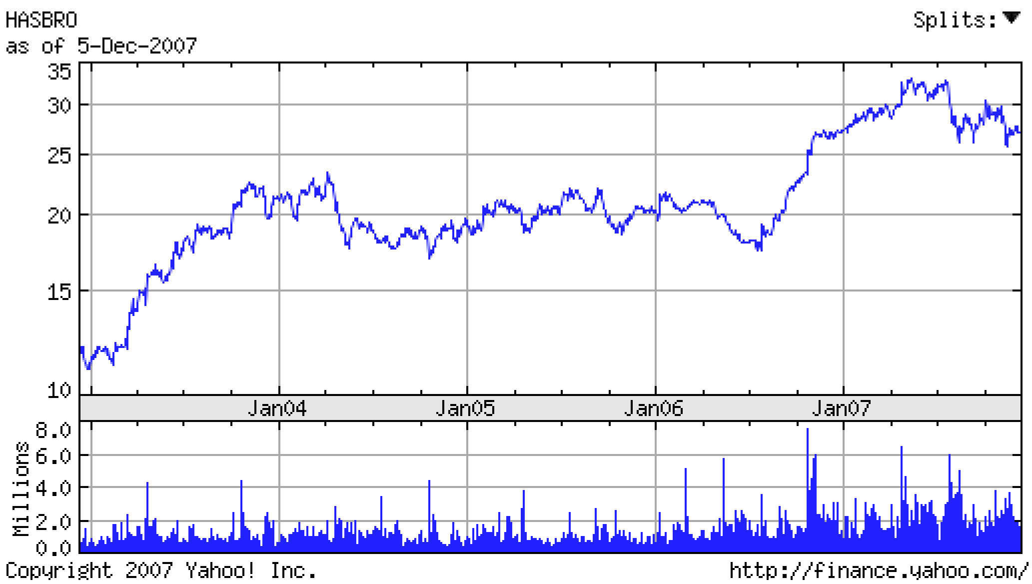
With just four months of the scandal, it is too early to assess whether Mattel is winning or losing market share. However, the incident has provided competitors with an easy target. To kick-off the Holiday shopping season, leading competitor and the world.'s second-largest toy company - Hasbro - issued 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.

MATTEL

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 is 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[3]. 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 case[4], 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.

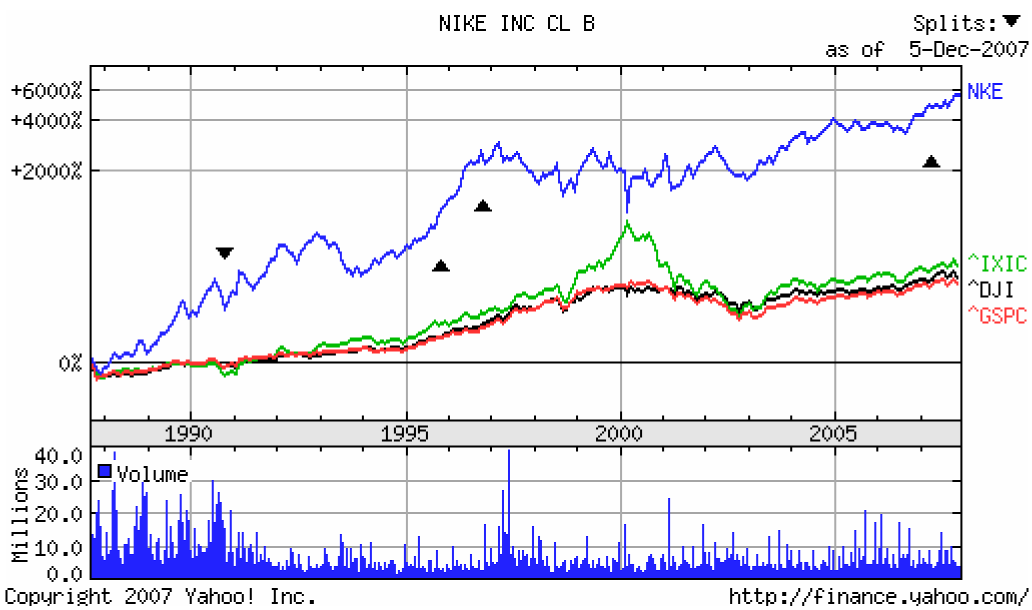
Pestridge also noticed a dramatic shift while recruiting on college campuses. Instead of aggressively pursuing jobs with Nike, students began questioning Nike.'s labor practices.

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 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).

[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

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 abuse."**



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[6]..'' 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 Nik.'s labor practices. Remnants of Nike's sweatshop scandal can be found all over the Internet. Google's search suggestion tool prompts users to search for "Nike sweatshops." based on search popularity;

[5] "Nike Inc.: Developing an Effective PR Strategy", *University of Western Ontario- Ivey School of Business,*
1999
[6] "Nike Inc.: Developing an Effective PR Strategy", *University of Western Ontario- Ivey School of Business,* 1999

Nike's Wikipedia page has a section entitled "Human Rights Violations[7]". 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.

Global Grocery Retailer: Crisis Averted

On December 19th, 2007, The Independent published an article entitled "Slave Labour that Shames America" implicating a Global Grocery Retail Chain (GGRC) as a party to slave labor.

> "Burger King is not the only buyer digging in its heels. GGRC, which recently expanded into Britain with a store in London's upmarket suburb of Kensington, **has been discovered stocking tomatoes from one of the most notorious Florida sweatshop producers. GGRC ignored an appeal by the Coalition of Immokalee Workers to pay an extra penny a pound for its tomatoes."**

A few months later, GGRC learned that the Coalition of Immokalee Workers (CIW), a fervent campaigner for workers' rights, had aligned itself with Fair Food Austin (FFA), a local group, to protest at the GGRC's annual shareholder meeting on March 10, 2008.

For GGRC, a company whose reputation is inextricably tied to the value of its brand, the results of its entanglement with the Coalition of Immokalee Workers could have been disastrous.

Proactive Actions Taken

Upon publication of the article in The Independent, GGRC immediately re-engaged The CSR Group LLC, an Austin-based CSR consultancy, who had already been working with the company on supply chain responsibility issues in China. The CSR Group quickly brought GGRC up to speed on the issues at hand and recommended a phased approach. It was decided to take the following actions:

- Develop a set of protocol upon which to conduct audits of the supplier in question.
- Conduct audits of the supplier in question.
- Engagement with Coalition of Immokalee Workers and Fair Food Austin.

Supplier Audits

GGRC scheduled audits with the supplier to determine whether the accusations of the CIW, the media, and other stakeholders had credence. GGRC paid for these audits, as opposed to asking the supplier to do so, to avoid possible conflicts of interest.

Engagement with Fair Food Austin
GGRC engaged with Fair Food Austin prior to the scheduled protest at the shareholder's meeting. GGRC raised the concern to Fair Food Austin's that the "penny per pound" program was neither working nor in place. GGRC and Fair Food Austin found common ground – agreeing that no one on either side wants to see people exploited. The meeting resulted in agreements on both sides: Fair Food Austin agreed to not be disruptive at the shareholder meeting and GGRC agreed to send a representative to Immokalee to see how the farm workers live and work through a CIW tour and meeting.

Engagement with the Coalition of Immokalee Workers
GGRC noticed a shift in the Coalition of Immokalee Workers tone after meeting with Fair Food Austin; the Coalition became less adversarial. The Coalition of Immokalee Workers (CIW) lessened the aggressiveness of their approach after the meeting with the company.

GGRC Reaps the Reward of Stakeholder Engagement
The annual shareholder meeting went smoothly. Attendees were not likely to even know a "protest" was occurring or planned; Fair Food Austin was not disruptive and media coverage/internet buzz was scant. No questions were raised on labor issues by the audience.

The Role of The CSR Group. LLC

The CSR Group advised a key member of GGRC extensively on good engagement practices in advance of her Fair Food Austin meeting including potential scenarios to prepare the company for what to expect, appropriate tone and how to present the company as open and inquiring, how to find common ground, how to speak to these issues, and how to consider agreements, etc. The CSR Group also advised this key member prior to the shareholder meeting on potential questions and how to address them, and how to respond to questions from stakeholders regarding steps the company has taken.

The CSR Group also provided GGRC with the following guidance regarding stakeholder engagement:

- Background on
    - experiences of other corporations
    - the CIW (including the organization's agenda, history of corporate engagement, outcomes of corporate negotiations, and state of relations between key regional stakeholders
- Advice on good practices for engaging with stakeholders to:
    - be prompt, open and honest
    - not deny, defend or challenge allegations - inquire, investigate, engage
    - use inquiry to develop discussion
    - acknowledge concerns and issues
    - find common ground around ISSUES (as opposed to specific allegations or required actions of any party) and common values around working conditions
    - accept that you may each have different views on the role of companies and others in taking actions

    - consider agreements carefully - don't promise things you can not deliver, investigate for yourself

- Recommendations for determining follow up actions and incorporating engagement experience into business strategies
- E.g. Agree to talk again with stakeholders, take steps to increase education about issues, each other and each other's perspectives (ex. GGRC's trip to Immokalee as good education for the company's key member and the company itself).
- Guidance to engage with key stakeholders, including suppliers and groups like CIW, before making decisions, plans or commitments.

The CSR Group lead (together with our audit partner, BV) the audit process to investigate the alleged issues in Florida and to inform GGRC management of the results in order to assess their options based on conditions of the supplier's sites.

Summary

The CSR Group's advice to GGRC helped them avoid what Nike experienced. When Nike was first accused of slave labor practices, they made the following mistakes: denial, failure to take responsibility for its supply chain, lack of engagement with stakeholders, failure to use a transparent auditing process, and one-way communication. GGRC, under The CSR Group's guidance, did not fall into these traps.

What Nike Did Wrong	**What GGRC Did Right**
Denial of the Issue	Acknowledgement of the issue
Failure to take responsibility for its supply chain	Taking responsibility for its supply chain
Not engaging with stakeholders	Active, honest engagement with stakeholders
Auditing process was not transparent	Third party audits to avoid conflicts of interest
Communication was one way (ex. *New York Times* ad)	Providing a forum for stakeholders to voice their concerns and create two-way communication

GGRC averted an embarrassing protest and avoided the negative experiences that other companies, like Nike and Mattel, have faced, such as loss of customer loyalty, brand erosion, dramatic supply chain realignment costs, and lower employee morale.
However, this aversion is temporary and fortuitous. The first steps taken by the company were ones that most of their competitors already have in place, and ones that their key stakeholders expected and assumed were already in place. GGRC currently has a market capitalization of roughly 18.49 billion dollars. A huge percentage of GGRC's market capitalization is tied to the high value of its brand. The high value of GGRC's brand is partially based on its corporate values and publicized commitments supply chain responsibility. Thus, billions of dollars in brand value are at stake for GGRC.

> "Compared with [competitors], GGRC stands out. Again, intangibles represent a much larger part of its market value, and the company is significantly more risky. Brands are part of this. GGRC CEO John Mackey puts it this way: "We are a lifestyle brand and have created a unique shopping environment built around

satisfying and delighting our customers." The brand positioning is at the heart of what has driven GGRC's growth. But as the company becomes larger, it will have to carefully manage this competitive advantage to mitigate risk[1]."

The CSR Group believes it is imperative that GGRC build upon its initial efforts with continued strategic stakeholder engagement and the development of a Supply Chain Responsibility™ program.

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[1] "Risk Jockey", Marketing Management published by the American Marketing Association, March/April 2007,