Nike's Operational Strategy Analysis and Financial Analysis Based on the Value Chain and Porter's Five Forces Model

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Abstract. This article helps to understand Nike's financial and operational situation. Firstly, the author conducted a value chain analysis of Nike and realized that Nike's core competitiveness lies in technology development and marketing. Then, an analysis was conducted on Nike's cost leadership strategy and differentiation strategy, and the advantages and disadvantages of Nike's were proposed. Secondly, based on the Porter Five Forces model, an analysis was conducted from five aspects: the threat of new entrants, the bargaining power of suppliers, the bargaining power of customers, the threat of substitutes, and industry competition. The fourth part conducts a ratio analysis of Nike Company. The author referred to its competitor Adidas and analyzed Nike's strengths and weaknesses by comparing its 2022 profitability ratios. Based on the above analysis, the author believes that Nike, as a leading enterprise in the sports industry, has maintained a positive development trend even after being hit by the epidemic. This article points out the shortcomings and areas worth learning from in Nike's production and operation activities and puts forward suggestions for other companies.

Keywords: Nike, value chain, generic strategies, Porter's Five Forces, ratio analysis.

1. Introduction

In 2019, the sports industry was impacted by the global COVID-19. Due to the suspension of various sports events and people's home lives, the sports goods market has also been greatly impacted. The sales of sports goods by major brands have significantly decreased, and many sports goods' stores have even closed. Moreover, due to the impact on manufacturing and logistics, the supply chain has also experienced disruptions, leading to a short-term stagnation of the sports goods market. Now, with the passage of time, the sports industry is gradually recovering.

As a leading enterprise in the sports industry, Nike has been affected by the epidemic, but the impact is not significant and the recovery is fast. This article takes the Nike Company in the United States as the research object. Nike is a famous sports brand, formerly known as Blue Ribbon Sports Goods Company. In 1972, Nike was officially established with its headquarters in Beaverton, Oregon. Nike designs, produces and sells footwear, clothing, sports equipment, and accessories worldwide.

This article first conducts a value chain analysis of Nike, followed by a generic strategies analysis. Secondly, Porter's Five Forces model analysis was conducted on Nike, and finally, a ratio analysis was conducted based on historical data and competitor Adidas. Based on the above-detailed analysis, the author pointed out the shortcomings and areas worth learning from in Nike's production and operation activities and proposed suggestions that have reference significance for other companies.

2. Value Chain Analysis

Value chain refers to a series of interrelated activities involved in the production and sales of products by an enterprise, which is divided into primary activities and support activities, as shown in Fig.1. Each activity has its own way of creating value. Enterprises can improve their overall competitiveness and profit margin by optimizing the processes of each link, controlling costs, improving product quality, and adding differentiated features. The value chain theory is widely applied in the fields of enterprise management and strategic planning [1]. This section will analyze

Nike's value-added process in internal and external value chain activities based on the value chain theory.

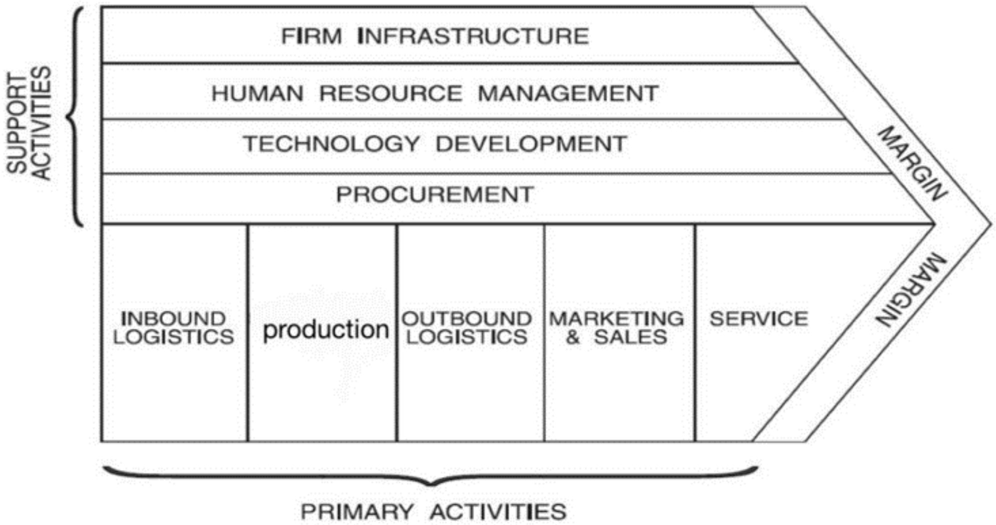

Figure 1. Value chain (Photo credit: Original)

2.1. Support Activities

Support activities are auxiliary work that can support the daily production and operation of enterprises. For Nike, the most important support activity is technology development. The analysis is as follows [2].

In support activities, Nike is mainly responsible for technology development, such as the air cushion of Nike shoes. Nike invests a lot of money every year to design and research sports products that combine fashion and comfort. Nike's product development center is known as the "Creative Kitchen" and is a place for Nike's product innovation, located at Nike headquarters in Oregon. When Nike develops new products, it collects professional opinions from international athletes to produce products with competitive advantages [3].

2.2. Primary Activities

As the sum of daily business activities of enterprises, primary activities include inbound logistics, production, outbound logistics, marketing and sales, and services. These activities are directly related to the processing and transformation of enterprise products, and they are the most basic value-added activities of the enterprise [1]. The most important activities are production and marketing and sales. The specific analysis is as follows.

2.2.1. Production

In production activities, Nike outsources the production process to many Asian countries. Nike has successfully reduced and controlled operating costs through outsourcing, saving a large amount of production infrastructure construction costs, equipment procurement costs, and labor costs. Nike fully integrates global resources and utilizes the world's cheapest labor force to manufacture products for it [4].

2.2.2. Marketing and Sales

In primary activities, Nike mainly undertakes marketing, which is the most value-added activity. Marketing is one of Nike's core competencies. Nike has attracted many customers through the slogan "Just do it", which is not only an advertisement but also a spirit. The continuation of this spirit has earned Nike long-term user trust and laid the foundation for brand cultural value.

In terms of sales, Nike keeps up with the times. With the development of the times, e-commerce enterprises led by Taobao and Tmall have rapidly emerged in terms of sales, bringing great discounts and convenient and fast shopping experiences to different consumer groups. Nike takes advantage of the Tmall Mall under Taobao. Relying on Tmall's online media coverage and Nike's excellent market sales, the Nike Tmall flagship store has gained consumer recognition and trust, while also achieving excellent sales performance [5]. At the Tmall 618 Shopping Festival in 2023, Nike's total transaction volume increased by two digits year-on-year, with over 2 million new members added [6].

3. Generic Strategies Analysis

3.1. Cost Leadership

The cost leadership strategy is to minimize product costs for enterprises while ensuring product quality and safe production. This leads to low unit profits and high sales. Compared with similar products in the market, it has improved

cost-effectiveness, enhanced brand value, and thus strengthened the company's core competitiveness. Therefore, Nike has adopted a cost leadership strategy. For example, after gaining experience in product production, Nike carried out large-scale production and gained many benefits from it. Nike is mainly responsible for core research and development, outsourcing production to factories with low labor costs. Therefore, Nike maximizes efficiency throughout the entire value chain. In addition, manufacturers collaborating with Nike have collaborated with local raw material suppliers to obtain raw materials, saving some costs.

The cost-first strategy creates entry barriers and reduces the threat of new entrants. But this also puts Nike under intense price competition. Price competition can lead to cost reduction, which can easily lead to many risks such as low product quality and poor after-sales service. For example, at a party on March 15, 2017, the Nike Hyperdunk 08 FTB (SKU: 869611-001) basketball shoe was found to have an incorrect description of the air cushion [7].

3.2. Differentiation

Michael Porter's concept of competitive strategy first proposed the concept of differentiation strategy, attempting to persuade customers to pay a premium by providing unique and ideal functions. The core of this strategy is not to reduce costs, but to continuously invest resources and develop products or services that customers consider competitive to meet their needs. Nike enjoys a global reputation and is an enduring brand. Nike's core focus is product development, constantly developing various new shoe styles, such as the Air Jordan series, to provide more beautiful and comfortable sports products. Nike achieves a differentiation strategy by continuously providing better product quality and services, developing more product types, and providing more flexible delivery methods.

Adopting differentiation strategies can significantly increase the difference between product prices and cost expenditures, enabling Nike to achieve higher profits while reducing consumer sensitivity to prices. However, this strategy also has certain drawbacks that can increase Nike's direct and indirect production costs. In addition, with the development of the industry, the advantages of differentiated products may be imitated by competitors, and the emergence of counterfeit products in the market will affect the competitiveness of enterprises [8].

While acknowledging the cost leadership strategy, it is also necessary to acknowledge the existence of differentiation strategies. The priority strategy of cost perception is important, but it cannot be overly exaggerated. Synergistic effects can achieve the effect of "getting twice the result with half the effort". Therefore, Nike cannot blindly reduce costs without considering cost differences, which can easily be replaced by better products from other companies. Nike can only achieve the lowest total cost for the enterprise by combining a cost leadership strategy with a differentiation strategy. Overemphasizing one party can have an impact on the company's market share [9].

4. Analysis of Porter's Five Forces Model

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The Porter’s Five Forces Analysis model was proposed by Michael Porter. When analyzing an industry and its competitors, it is proposed that the competitiveness of an industry is determined by five forces: the threat of new entrants, the bargaining power of suppliers, the bargaining power of customers, the threat of substitutes, and industry competition. The combination of the five forces not only affects the attractiveness of the enterprise but also plays a decisive role in the competitive strategic decision-making of the enterprise organization [10]. This model is typically used for industry analysis and strategic research. The author's analysis of Nike's five forces is as follows:

4.1. Threat of New Entrants

Creating a new brand requires a lot of resources, and Nike has a high reputation globally, which makes it difficult for new entrants to reach such a level. Therefore, the conversion cost for customers is also high. Marketing is one of Nike's core competencies, and Nike, a sports brand, is deeply rooted in people's hearts. If customers purchase products from other companies, they need to bear the cost of psychological feelings, such as rebuilding trust relationships, overcoming uncertainty, etc. When unit costs decrease with the increase of supply, large numbers of employees have advantages over smaller entrants, who must enter on a large scale or accept cost disadvantages. In summary, the threat of new entrants is relatively small.

4.2. Bargaining Power of Suppliers

Nike's products are produced in many countries, and there are strong constraints between suppliers. The bargaining power of both supply and demand sides mainly depends on the adequacy of resources and the strength of market demand. Low supplier concentration is not about huddling for warmth, but rather a single attack, which is not conducive to the centralized management and voice of suppliers, jointly safeguarding their own interests, and their bargaining power naturally decreases. The products provided by suppliers are not differentiated products. Nike's main value chain activity is to develop differentiated products, so the supplier's bargaining power is lower.

4.3. Bargaining Power of Customers

Nike has a large number of consumers worldwide, and many large wholesale customers have high bargaining power. Due to Nike's strong brand image and continuous innovation in products and designs, the bargaining power of end consumers is relatively low. High customer concentration leads to low bargaining power. Moreover, the high concentration of Nike's industry means that leading companies have a more significant competitive advantage because they have more resources, stronger bargaining power, and higher profitability.

4.4. Threat of Substitutes

Substitutes come from outside the industry. If the price of one product increases the demand for another, then two products are substitutes. Due to the low cost of counterfeit products, their cost-effectiveness is higher compared to genuine products. This product has extremely high tightness as a substitute. The threat of counterfeit products is highly likely to threaten the company's sales in emerging markets and may also affect the original brand value.

4.5. Industry Rivalry

Due to constantly changing consumer preferences and manufacturing technologies, competitors have diversified their strategies. There are many competitors in the market with similar sizes and instances, such as existing competitors and emerging companies such as Adidas, Puma, and Under Armour. Value competition threatens profits and industry growth is slow.

5. Ratio Analysis

5.1. Profitability Ratio

1) gross profit margin = (gross profit/ revenue) *100%

Gross profit margin is a financial indicator used by analysts to evaluate a company's financial condition. Simply put, a company's gross profit margin is the money earned after considering operating costs It can be used to analyze the basic operating profitability of enterprises in the production and sales processes.

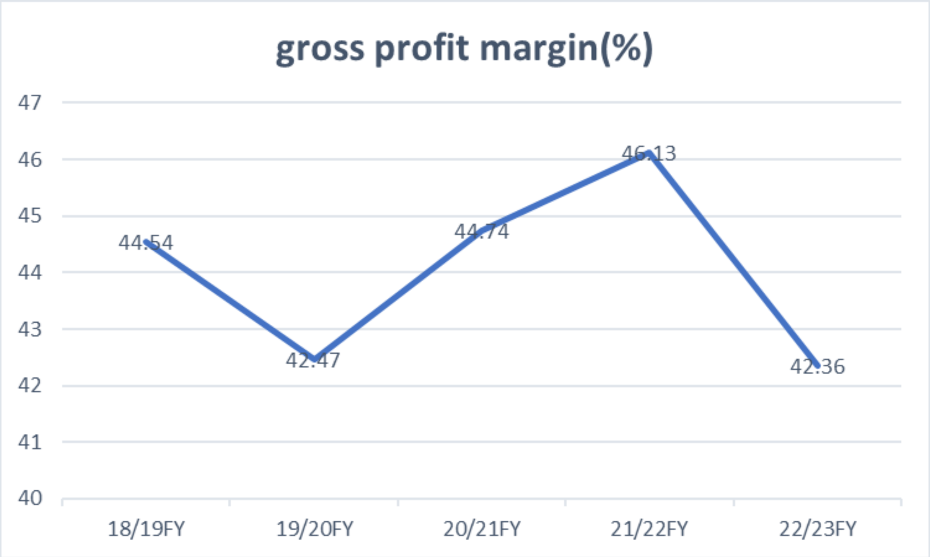

Figure 2. Nike's gross profit margin over the past five years (Photo credit: Original)

From Fig.2, it can be seen that due to the impact of the epidemic, Nike's gross profit decreased from 44.54% in fiscal year 18-19 to 42.47% in fiscal year 19-20. Although the gross profit margin briefly increased thereafter, it even reached 46.13% in the fiscal year 21-22. However, the gross profit margin for fiscal years 22-23 decreased from 46.13% the previous year to 42.36%, reflecting Nike's weakened profitability, possibly due to insufficient core competitiveness or fierce competition, resulting in oversupply of products.

2) net profit margin= (net profit/ revenue) *100%

Net profit margin is a key financial metric that also points to a company's financial health. Also referred to as net margin, it indicates the amount of profit generated as a percentage of a company's revenue.

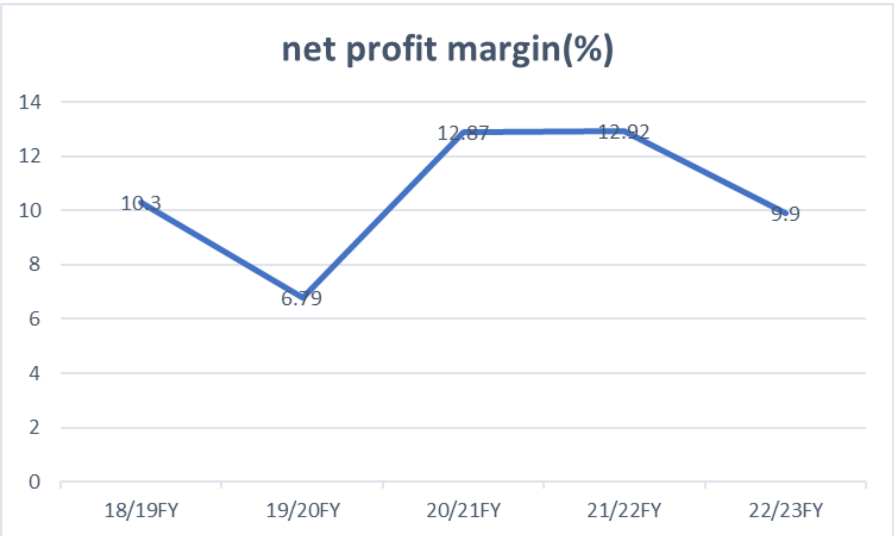

Figure 3. Nike's net profit margin over the past five years (Photo credit: Original)

From Fig.3, it can be seen that due to the impact of the epidemic, Nike's net profit for the fiscal year 19-20 significantly decreased to 6.79%, the lowest in nearly five years. Subsequently, it increased to 12.07% in fiscal year 20-21 and 12.02% in fiscal year 21-22. In the fiscal year 22-23, the net profit margin decreased to 9.9%. From the above data, it can be seen that despite the impact of the epidemic, Nike's net profit margin has recovered quickly. It indicates that Nike has good operational efficiency and strong operational capabilities.

3) Return on equity= (net income/average equity) *100%

Return on equity (ROE) is the rate of return on shareholder equity, which is a measure of the return on a company's interests relative to shareholder investments. The higher the ROE, the more profits a company can generate and improve shareholder returns through the use of shareholder capital.

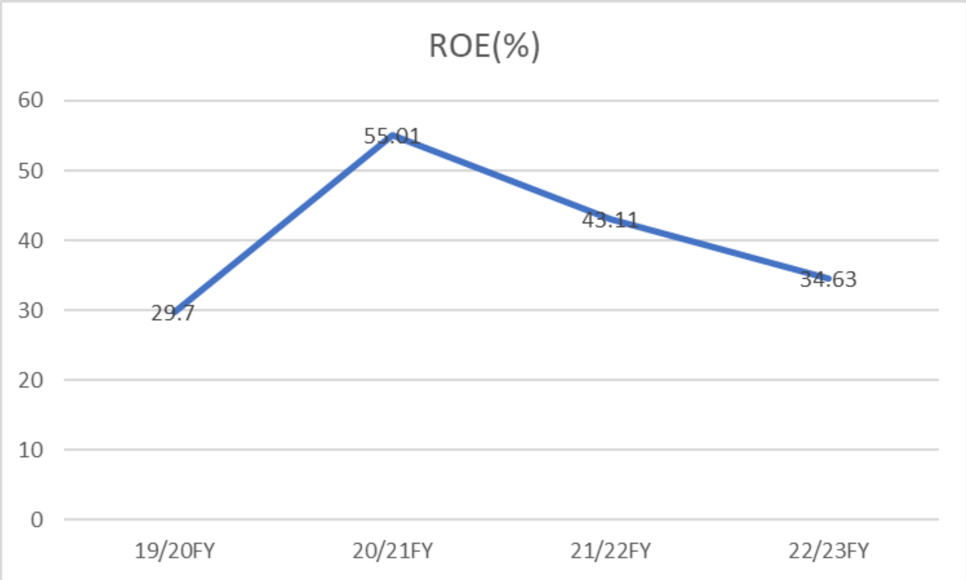

Figure 4. Nike's ROE over the past four years (Photo credit: Original)

From Fig.4, it can be seen that although Nike's ROE was as high as 55.01% in fiscal years 20-21, it was 43.11% in fiscal years 21-22 and as low as 34.63% in fiscal years 22-23. From this, it can be seen that the value of ROE is showing a downward trend, indicating that Nike's ROE is continuously declining. This indicates that Nike's operational efficiency is declining, possibly due to fierce market competition or improper management. Nike company wants to improve the economic efficiency of the enterprise, it is precisely with ROE as the core, do a good job in capital operation, and optimize the capital structure [11].

5.2. Comparison with Other Companies

The author chose Adidas as the benchmark. Adidas is Nike's largest and strongest competitor in the US market. With similar clothing, footwear, and accessory product lines, these two brands have dominated the sportswear industry for nearly 60 years. Nike has a market share of approximately 27.4% in the US market, while Adidas has a market share of 15.6%. According to the 2022 Cross Brand Global Brand Ranking Report, Nike ranks 10th and Adidas ranks 42nd. Comparing financial ratios with major competitors can highlight Nike's strengths and weaknesses among competitors.

Table 1. Comparison of profitability ratios between Nike and Adidas in 2022

Company	Gross profit margin	Net profit margin	ROE
Nike	46.13%	12.92%	43.11%
Adidas	47.3%	2.83%	26.46%

1) Gross profit margin

As shown in Table 1. Adidas' gross profit margin in 2022 is 47.3%, while Nike's gross profit margin is 46.13%. The gross profit margin of Adidas is slightly higher than that of Nike, indicating that Adidas has a high profitability in its core trading activities. In order to improve the efficiency of Nike's core trading activities, Nike can consider reducing direct costs. For example, negotiating with suppliers to reduce raw material costs without affecting product quality.

2) Net profit margin

From Table 1, it can be seen that in 2022, Nike's net profit margin was 12.92%, while Adidas had only 2.83%. Nike had a slightly lower gross profit margin but a much significantly higher net profit margin, indicating that Nike did a good job in controlling other operating expenses including marketing, selling and administrative expenses, etc. Generally, the operation of Nike was much more efficient than Adidas and its financial health was in good condition. On the contrary, Adidas may face operational risks or significant market competition pressure.

3) ROE

Nike has a return on equity of approximately 40%, indicating its ability to convert $1 of capital into a profit of $0.4. Nike's ROE is almost twice that of Adidas, which means Nike's profitability is stronger than its competitors. Nike's extremely high ROE proves Nike's ability to generate revenue. But this may also indicate that equity is not sufficient to meet the risks of company operations, so Nike should develop policies to attract more capital and investment.

6. Conclusion

This article conducts value chain analysis, generic strategies analysis, Porter's Five Forces model analysis, and ratio analysis on Nike Company. Through value chain analysis, it can be understood that Nike is doing well in marketing and technology research and development. Product outsourcing can save a lot of costs. Secondly, through generic strategies analysis, the author found that it is necessary to combine cost priority strategy with differentiation strategy in order to achieve the lowest total cost for the enterprise. Then, Nike was analyzed using the Porter Five Forces model. Finally, some issues with Nike were raised through profit ratio analysis. Through ratio analysis, the author found two issues with Nike. The first is the weakening of the company's profitability. Nike should strengthen cost control. For example, the sales and production departments should have symmetrical information to avoid product backlog. It can both reduce costs and increase revenue. Secondly, Nike can increase profit margins by increasing the pricing of products and services and improving production processes. The second issue is that Nike's ROE is showing a decreasing trend, indicating that Nike's operational efficiency has deteriorated. Nike should optimize the company's capital structure by changing the structure of its assets and liabilities, such as reducing debt and increasing equity, in order to improve its ROE level. Nike can also improve ROE by developing effective risk management strategies and strengthening internal controls and supervision to reduce risks. Overall, Nike is a leading enterprise in sports products, with a positive development trend. However, due to the limited and incomplete data available, this article can only provide a brief analysis of Nike's profitability ratio. The analysis of Nike's liquidity ratio, efficiency ratio, and investment ratio can be based on more detailed data.

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