



## GRADUATE SCHOOL OF BUSINESS STANFORD UNIVERSITY

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### NIKE – CHANNEL CONFLICT

As 1999 drew to a close, Mary Kate Buckley, general manager of nike.com, knew her division was at a crossroads. Over the last year, nike.com had rolled out an ambitious e-commerce initiative, signed an exclusive deal with Fogdog sports that allowed NIKE products to be sold by a pure Internet company for the first time, and had grown from twelve to 150 employees. But nike.com faced critical decisions in the coming months. Specifically, it needed to plan its own direct-to-consumer sales strategy and its policies for other vendors on-line sales of NIKE products.

#### COMPANY HISTORY, STRATEGY, AND STRUCTURE

BRS, the company that would evolve into NIKE, was founded in 1964 by Phil Knight to make high-performance athletic shoes for the U.S. market. Knight, a Stanford MBA and middle distance runner at the University of Oregon, recognized that inexpensive, well-made Japanese imports could fill an unmet need for quality athletic footwear. Knight started selling these imported shoes directly to runners at track meets in his spare time, and NIKE was born.

Over the following 35 years, NIKE grew from a part-time job for Phil Knight into the world's dominant athletic footwear and apparel company by following a consistent and logical strategy: to capitalize on the importance of sports in people's lives and to be identified with competition and victory in consumers' minds (the company is named for the Greek goddess of victory).

Located on a bucolic campus in Beaverton, Oregon, NIKE stood out as atypical for a large apparel company. Its culture was famous for internal collegiality and outward competitiveness, a tribute to Phil Knight's influence. Knight had held close control of the company since its founding and had ruled with a mix of closely allied senior managers.

The company's brand management efforts focused on endorsing the best possible athletes and making the famous NIKE swoosh emblem ubiquitous. The roster of athletes who wore and promoted NIKE products read like a multi-sport hall of fame, including mega-stars such as Michael Jordan, Tiger Woods, Mia Hamm, and Ken Griffey, Jr.

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Research Associates Katherine McIntyre and Ezra Perlman prepared this case under the supervision of Professors Garth Saloner and A. Michael Spence as the basis for class discussion rather than to illustrate either effective or ineffective handling of an administrative situation. Margot Sutherland, Executive Director, Center for Electronic Business and Commerce, Stanford Graduate School of Business, managed the development of this case.

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NIKE went to tremendous lengths to promote its brand and image across the world. It typically spent over 11% of revenues on advertising, sports marketing, and promotional spending, or nearly one billion dollars in fiscal year 1999 (Exhibit 1). NIKE's advertising included controversial campaigns that stressed winning above all else. Other campaigns were downright whimsical, basketball encounters between humans and loveable cartoon creatures.

NIKE was highly centralized and focused. Management concentrated on core corporate functions, such as brand building and supply chain management while a dedicated sales force sold NIKE products to retailers or, in a few of countries, to distributors.

## **NIKE VALUE CHAIN**

### **Manufacturers / Suppliers**

Consistent with its original strategy, NIKE outsourced most of its footwear manufacturing to low-cost Asian or South American manufacturers. By 1999, the primary locations for NIKE production were Indonesia, Vietnam, Korea, and China. Managing its global supply chain was a core strategic advantage for NIKE, and its operations ensured smooth integration with contract manufacturing.

The company worked with hundreds of manufacturing partners to develop long-term, trusting relationships. Manufacturing partners did not necessarily provide the cheapest production, but most of them delivered consistent, timely-shipped goods that met NIKE's high standards. The partners invested to manufacture new designs or features, knowing that production levels would offset the investment.

NIKE generated its own new product ideas and managed the design process in-house. Once a design was perfected, a manufacturer would begin the eight-month cycle of developing volume production capabilities in all the relevant sizes. Once production was on-line, NIKE could expect manufacturers to fulfill orders within 90 days, plus 30 days for shipping by sea freight.

### **Product Lifecycle**

Getting a new athletic shoe model on a store shelf could take 15 to 18 months from initial planning to final product distribution. Volumes were determined long before shoes arrived at consumer outlets, requiring careful forecasting from NIKE and its merchants. A typical new NIKE shoe had a market life of 3 to 6 months from introduction to depletion of inventories. Because the product life was so much shorter than the production cycle, Nike could not adjust production runs to meet unexpected consumer demand. As a result, NIKE did not try to match supply of any given shoe model with demand, preferring instead to set conservative production targets and then begin designing the next generation model.

A typical NIKE factory produced between 2,000 and 3,000 pairs of shoes a day, implying a three month production run for a line that would sell 200,000 shoes. It was difficult for NIKE to make money on smaller production runs, although it did produce specialty shoes at lower volumes.

## **Retail Sales Channel**

NIKE sold its products through a large in-house sales force in different types of stores – multi-sport general athletic department stores, specialty athletic department store retailers and general-purpose shoe stores. Despite the company's origins selling shoes straight to track runners from the back of Phil Knight's car, NIKE had not been very interested in direct-to-consumer sales. The company lacked a catalog or mail-order business and had only a few stores of its own, called NIKETowns that were more a marketing and brand-building effort than a source of sales.

Athletic footwear and apparel was a fragmented retail market (Exhibits 2 and 3). The top ten sporting goods retailers represented 14% of total U.S. sales. Because these retailers were so small, they had been slow to use sophisticated technology to track purchases and inventory, leading to frequent stockouts and misallocations of inventories. NIKE had suffered from imperfect information about retailers' inventory levels and wanted to improve inventory monitoring.

NIKE's 40% market share in U.S. athletic footwear gave it influence with the merchants who carried its products. The company encouraged advance planning from its retail partners – nearly 90% of its orders from retailers were for deliveries nine months out. As a result, NIKE could plan manufacturing and distribution far in advance to meet its guaranteed future sales. NIKE could also negotiate favorable contract terms with its retailers, including displays, inventories, and other details that influenced consumers.

The company distributed most of its own products from its factories to retail stores or distribution centers through a complex process: a retailer's monthly order of 300,000 pairs of shoes could involve shipping over 50 different models to 100 different locations. In the late 90s, NIKE invested over \$1 billion in large regional distribution centers to replace its smaller centers. NIKE also gave discounts to retailers who managed their own distribution from the NIKE factory, thus avoiding the need to go through a NIKE distribution center. NIKE tried to keep inventories to a minimum and managed over 5 inventory turns a year.

## **Direct Sales Channels**

In 1999, NIKE owned and operated 13 NIKETown superstores, most of them in high-traffic, upscale shopping neighborhoods. The first NIKETown store opened in Portland, Oregon in 1990. Its designer described it as a cross between the Smithsonian, Disney World, and Ralph Lauren. While the store sold a broad range of NIKE footwear and apparel (at full retail price), its layout and merchandise also made it a showcase of NIKE products.

Nike followed the Portland store with a 70,000-square-foot operation located in downtown Chicago that quickly became the city's largest tourist attraction; 7,500 visitors a day flocked to see the two-story mural of Michael Jordan and try NIKE shoes out on the store's miniature basketball court.

The NIKETown stores were not run to be independently profitable, or even to be major selling channels for NIKE products. Instead, they were showcases for NIKE's newest or most innovative product lines, an opportunity to strengthen ties with consumers, and an extraordinary brand

advertising opportunity. They also carried hard-to-find products or specialty items not available from typical retailers and souvenir items, such as the Michael Jordan paraphernalia sold at the Chicago store. Initially, retailers feared that they would lose sales to NIKETown stores, but they were reassured as the company's intentions became clearer. Some within NIKE felt that the efforts to appease retailers' concerns about competing directly with NIKE had prevented the NIKETown stores from realizing their full potential.

NIKE also operated 53 outlet locations to liquidate overstocked or outdated inventory. This channel let Nike control price and quality while disposing of excess inventory without ceding too much control by relying on other liquidation channels.

## **THE SPORTING GOODS E-COMMERCE LANDSCAPE**

The on-line market for sporting goods in 1999 was chaotic. Various competitors were eager to join the Internet frenzy – traditional sporting goods retailers, manufacturers that wanted to selling direct to consumers, and start-up companies wanted to exploit the Internet. Global Sports, Inc. (GSI), an Internet start-up with an innovative outsourcing-based business model, complicated the picture.

### **Traditional Retailers**

Virtually every significant sporting goods retailer had established a web presence by late 1999. Retailers, such as Foot Locker and Copeland's Sports, had their own web businesses, typically offering a full range of products at prices similar to what was charged in their stores. These real-world retailers leveraged their existing brands and operational capabilities to offer extensive shopping experiences. Footlocker.com, for example, offered over 14,000 products from 150 different manufacturers at prices equal to or lower than in-store prices. It also offered in-store returns of on-line purchases.

In 1999, six of the 20 largest sporting good retailers, including The Athlete's Foot and The Sports Authority, signed deals with the Internet division of GSI, to manage their websites and their complete e-commerce operations. GSI would handle the design, order fulfillment, processing, shipping, and business development of the retailers' Internet businesses. The participating retailers simply chose their product lines and pricing strategy, and generated web customers, but GSI managed the rest of the process. By developing a common sporting goods e-commerce infrastructure for its multiple retail partners, GSI claimed to lower the costs associated with e-commerce. Each retailer collaborated with GSI in decisions related to its brand presentation, website, and e-commerce operations.

### **NIKE's Direct Competitors**

NIKE's competitors, the other leading athletic footwear and apparel manufacturers, faced similar dilemmas and problems related to their own e-commerce strategies. Because these competitors were smaller and less powerful than NIKE, they relied even more on their traditional retail partners for sales. These companies had little or no experience selling directly to consumers and entered into e-commerce differently.

By late 1999, NIKE's major competitors (Adidas, Converse, Reebok, and New Balance) had established websites with detailed product information, store locators, and editorial content about athletes or events. Each competitor, however, took a slightly different approach to the strategy and operation of its e-commerce capabilities. Converse neither sold its products online nor offered information about how to acquire them online. Adidas and Reebok each offered limited product lines at full retail prices to their Internet customers. New Balance adopted a hybrid approach, allowing customers to select any of its current products and then directed them to the websites of its affiliated retailers (both real-world and Internet-only) that carried those products.

NIKE's competitors were more willing than NIKE to allow retailers to sell their products over the Internet. They also exerted less control over the retail experience than NIKE and gave to more flexibility their Internet retail partners. Reebok allowed both on-line only and bricks-and-mortars retailers to offer their full product lines (often at a discount) on their websites. New Balance was slightly more protective of both product offerings and pricing, but unlike NIKE did not exclude Internet retailers from entire product lines. Adidas was the only major competitor who had taken a similar position to NIKE, severely restricting sale of product online.

### **Pure On-line Start-ups**

As in other consumer segments, sporting goods attracted a number of Internet entrepreneurs seeking to take advantage of the new technology to exploit the inefficient cost structure of traditional retailers. These Internet endeavors included full-range retailers (such as fogdog.com) and specialized niche players (such as lucy.com, for women's sports, or chipshot.com, for custom-made golf clubs). Many sports media concerns were also eager to leverage their viewer base into e-commerce customers. ESPN.com, a division of Walt Disney Corporation, and SportsLine.com (partially owned by CBS) each had avid followings among sports fans due to the content they had leveraged from their media conglomerate owners. Each of those companies were pushing to convert their website viewers into purchasers.

## **NIKE'S INTERNET STRATEGY**

### **Other Internet Sellers (Non-NIKE)**

As new on-line retailers opened and traditional retailers launched their own Internet initiatives, merchants bombarded NIKE with requests to sell its products on-line. Initially, the company was extremely hesitant, worrying that careless Internet retailers would dilute the Nike brand value.

"We saw a lot of online retailers who were not putting the right emphasis on product presentation," explained Mary Kate Buckley. "Our bricks-and-mortars partners offer a convenient location where customers can feel the product quality and try products on ... we were concerned that over time if everyone is selling the same thing online, the only difference would be price."<sup>1</sup>

NIKE's traditional retail partners wanted to expand into on-line sales, but NIKE moved cautiously, allowing its largest retail partners to sell its products on their websites, if they

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<sup>1</sup> "Nike, Long Wary of E-Marketers," Links Up With Fogdog." New York Times. September 27, 1999.

maintained the same standards the stores enforced. Foot Locker and Copeland Sports (through its shopsports.com division) each started selling NIKE products, but Copeland quickly learned that NIKE meant what it said. In the summer of 1999, NIKE stopped selling to shopsports.com because "they were not meeting our marketing standards."<sup>2</sup> Although NIKE soon resumed sales to shopsports.com, it had made its point. By the end of 1999, NIKE had approved ten of its bricks-and-mortar retail partners to sell NIKE products over the Internet. It doubted, however, that those retailers could deliver acceptable service levels and monitored their performance carefully.

Some Internet sellers acquired NIKE products from other retailers' overstocks and other unofficial channels. Once these goods had passed from the hands of NIKE-authorized retailers, NIKE could no longer affect over how they were marketed or priced. Because NIKE handled its own international distribution and liquidated inventory through its own outlets, it saw less of these after-market re-sales than other manufacturers. NIKE also strictly enforced sales agreements with retailers and policed the web for offenders.

### **Fogdog Deal**

In September 1999, NIKE signed a deal with Internet sporting goods retailer Fogdog Sports that allowed Fogdog to sell the entire NIKE product line on its website. It gave Fogdog exclusive access (among Internet-only sellers) to the NIKE product line for six months in return for warrants to buy up to 12% of Fogdog's shares at a pre-IPO valuation.

Fogdog Sports was founded in early 1998 (as SportSite.com) to sell athletic gear directly to consumers over the Internet. The company was the evolution of a web design and e-commerce company that three graduates of Stanford University started in 1994. In 1998 VenRock Associates and Draper Fisher Jurvetson gave it venture capital financing. In September of 1999, after negotiations with NIKE had begun, Fogdog hired Tim Joyce, formerly VP of Global Sales at NIKE, as its new president.

After repeatedly rebuffing Fogdog, Nike was finally attracted to Fogdog's reputation and its pricing policy of respecting manufacturers' recommended minimum prices. Fogdog was able to point to three years of consistently executing its pricing policy. Its ownership stake gave NIKE an incentive to make the deal work. It agreed to treat Fogdog like any other major account, giving it preferred prices, joint promotions, and information sharing. Nike also gave Fogdog other special considerations, such as product images for display on the fogdog.com website, product and sales data, and unusual return privileges.<sup>3</sup>

NIKE also agreed not to sell to other virtual retailers for at least six months, including those sites Global Sports, Inc. managed. This promise angered some of NIKE's most important bricks-and-mortar partners, such as The Athlete's Foot, which relied on NIKE for 40% of its footwear sales. As Michael Rubin, the CEO of GSI, commented: "Our six partners are all among NIKE's top 20 accounts. NIKE needs to support them, and they need to be on the Internet in order to survive in the 21st century."<sup>4</sup>

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<sup>2</sup> Conversation with Mary Kate Buckley, VP, Nike, January 7, 2000.

<sup>3</sup> Conversation with Mary Kate Buckley, VP, Nike, January 7, 2000.

<sup>4</sup> "Nike, Long Wary of E-Marketers," Links Up With Fogdog." New York Times. September 27, 1999.

**nike.com**

Nike launched the nike.com website in August 1996 to provide information and entertaining content to its customers. The site had no e-commerce capabilities; instead, it reflected a typical NIKE approach to brand building. Different sports received their own separate pages, with tips and advice from NIKE athletes, news and updates on sports events, and detailed product information, including design inspirations and athlete endorsements. Despite the lack of e-commerce and no efforts to drive traffic to the site through advertising expenditures, nike.com logged 14 million visitors in 1998.

At first, NIKE approached the Internet with caution. A plan to sell posters on the NIKE website was considered for nearly a year before being launched during the Christmas 1998 season. Over the next year, however, NIKE's website strategy evolved substantially. In February 1999, Nike launched a test to sell its high-end Alpha Project line of footwear and apparel. It also redesigned the website to provide a store locator and more detailed product information.

In June 1999, NIKE re-launched a completely overhauled and redesigned website, with expanded e-commerce functionality. NIKE made hundreds of its most popular products available for purchase, all at full retail prices. For the first time, the company's senior management seemed to understand the revolutionary importance of the Internet. Phil Knight admitted that "on-line commerce is a partial return to our original roots of selling products at track meets from the trunks of our cars -- rekindling the direct relationship between NIKE and its consumers."<sup>5</sup>

Despite the push into e-commerce, much of Nike's website focus remained on brand-building and inspirational content. NIKE added profiles on its athletes, new information on future product development, and innovative technologies. Many of the web functions were so advanced that consumers could not use them without downloading plug-ins. "I wouldn't say we're on the bleeding edge of design technology, but I will say we're on the bruised edge," said nike.com's creative director, Bob Lambie.<sup>6</sup>

**MANAGING NIKE.COM****Operational Concerns**

Running a successful e-commerce business required operational capabilities that NIKE lacked. Because NIKE had no experience with remote order fulfillment, it could not pick, pack and ship orders, track delivery, or handle customer service. Rather than building each of those capabilities from scratch, NIKE outsourced them to United Parcel Service (UPS) which provided warehousing and shipping and as a call center with 500 dedicated customer service operators. Entrusting its brand identity to another company was uncharacteristic, but NIKE believed it was preferable to doing an inferior job in-house and would enable it to learn and gather data.

To satisfy its e-commerce customers, NIKE needed vital new skills in web design, systems infrastructure, and other related IT areas. The company outsourced many of these needs and

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<sup>5</sup> PR Newswire, June 22, 1999.

<sup>6</sup> PR Newswire, June 22, 1999.

relied on proven market leaders like InterWorld Corporation for its enterprise commerce software and Red Sky Interactive for website design and production.

### **Strategic Concerns**

The dedication to direct e-commerce over the nike.com website raised strategic concerns for NIKE and its partners. Traditional retailers of NIKE products, always concerned about being cannibalized by direct sales, were more worried than ever before as they were denied the opportunity to compete head-to-head with NIKE for Internet customers. NIKE knew it would have to strike a difficult balance to reassure its traditional retailers while expanding its own direct sales efforts. NIKE hoped maintaining full retail pricing on its site would alleviate traditional retailers' concerns over unfair competition. "We are hoping that our website will expand the pie, not take market share away from retailers,"<sup>7</sup> explained Mary Kate Buckley. Nevertheless, NIKE understood that the real opportunity for nike.com lay in defining a new, more profitable channel for selling shoes and other goods to consumers. "We want to be cognizant of channel conflict," said Buckley, "not apologize for it."<sup>8</sup>

NIKE was also concerned about the experience of its e-commerce customers. NIKE had never had significant direct contact with consumers and needed to make the shopping experience consistent with the NIKE brand. For "touch and feel" products like athletic shoes, NIKE would have to find creative ways to satisfy customers' desire to know how the products looked and fit. It was hard to see how NIKE could fulfill that need without continuing support from its bricks-and-mortars partners.

As NIKE considered further expansion into e-commerce, it had to rethink its approach to all of its core functions. Manufacturing standards would have to change if NIKE was to ship goods directly to consumers who had to rely on consistent sizing for sight-unseen purchases. NIKE needed to learn manufacturing planning and inventory management to satisfy uncertain consumer demand rather than pre-determined retailer orders. By customizing marketing, the web made NIKE rethink its approach to selecting athletes. It could now use athletes with smaller but intensely loyal fan bases. Direct-to-consumer sales also allowed prices to be more flexible and forced NIKE to better understand price sensitivity across narrow bands of consumers.

### **Organizational Issues**

The rapid growth and extraordinary potential of nike.com created difficult organizational dilemmas. The initial stages of NIKE's e-commerce launch were conducted in stealth mode by a small team that reported directly to the president of the company. Decisions were made quickly and often secretly, in contrast to NIKE's culture of candor and consensus. The media eagerly reported any new developments and speculated on what the future held for nike.com.

Once it became clear that nike.com would play an integral role in the future of the company, it became a vastly larger and more visible department. Nevertheless, it retained an aura of distinction within the company. At a time of disciplined spending within NIKE, the online division had an enviable budget. When nike.com began reporting directly to Phil Knight in the summer of 1999, its stature within the company and in the media increased. Despite rapid

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<sup>7</sup> "Nike swooshes into Internet retailing," Financial Post. June 24, 1999, p. C4

<sup>8</sup> Conversation with Mary Kate Buckley, VP, Nike, January 7, 2000.



headcount growth and a preference for internal candidates, nike.com could not satisfy the ever-growing roster of internal applicants.

As other NIKE departments began to realize nike.com's importance, they became involved in its strategic decisions. The sales department helped to ensure that on-line sales policies were consistent with NIKE's fundamental standards and policies. The manufacturing department collaborated on plans to produce customized shoes for specific on-line customers based on individual preferences. The marketing department assessed how to modify real-world advertising for the on-line world.

### **New Opportunities**

NIKE's e-commerce operations presented opportunities that were not available to NIKE under its old wholesaling model. For the first time, NIKE could directly collect considerable data about both customer demographics, and shopping habits – price sensitivity, purchase frequency, and product bundling. This information enabled NIKE to market new goods or services to exactly the right customers, increasing the effectiveness of its marketing.

Perhaps the most important new opportunity to NIKE was the ability to capture the enormous mark-ups between wholesale and retail prices for its goods (see Exhibit 4 for a breakdown of the value chain). Throughout its history Nike had managed its value chain successfully while only participating in the central and core functions. By not manufacturing or selling in-house, NIKE had grown dramatically while remaining profitable. Encroaching into the new territory of direct sales presented NIKE with an opportunity to capture more of the value chain than ever before.

### **THE FUTURE**

NIKE understood throughout 1999 that it had to learn how to do business over the Internet. Mary Kate Buckley explained NIKE's Internet philosophy in June 1999: "The new site is really just the next stage in a grand experiment. . . More than anything, our work over the last six months has proven that the future of Internet presence for a global brand like NIKE will be in a constant state of incubation."<sup>9</sup> Buckley also understood that nike.com had to define a new, more profitable way to sell products to its loyal consumers. She began to think about what NIKE should do in the year 2000.

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<sup>9</sup> PR Newswire, June 22, 1999.

**Exhibit 1****NIKE Financial Results, 1997-1999**

(in million)

<b>YEAR ENDED MAY 31,</b>	<b>1999</b>	<b>1998</b>	<b>1997</b>
Revenues	\$8,776	\$9,553	\$9,186
Costs and expenses:			
Costs of sales	5,493	6,065	5,503
Selling and administrative	2,426	2,623	2,303
Interest expense	44	60	52
Other income/expense, net	21	21	32
Restructuring charge, net	45	130	-
Total Expenses	8,031	8,900	7,891
Income before income taxes	746	653	1,295
Income taxes	295	253	499
Net income	\$451	\$400	\$795

*Source: NIKE Annual Reports***Exhibit 2****U.S. Athletic Footwear Retail Outlet Market Share**

	<b>1993</b>	<b>1994</b>	<b>1995</b>	<b>1996</b>	<b>1997</b>	<b>1998</b>
Discount Stores	14.0%	15.9%	16.2%	14.7%	14.8%	14.4%
Athletic Shoe Stores	21.9%	19.5%	18.9%	20.0%	19.4%	19.9%
General Shoe Stores	11.8%	10.7%	9.7%	9.8%	9.2%	8.8%
Sporting Goods	12.9%	12.7%	12.5%	12.6%	13.2%	13.2%
Department Stores	22.0%	22.8%	22.3%	22.2%	21.5%	21.5%

*Reproduced with permission from SGMA Athletic Footwear Market Index by NPD.***Exhibit 3****Projected Footwear and Apparel Sales, 1998 - 2003**

<b>(\$BN)</b>	<b>1998</b>	<b>1999</b>	<b>2000</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>
Footwear	0.05	0.1	0.2	0.3	0.6	1.2
Apparel and Accessories	0.4	0.8	1.4	2.4	4.1	6.7
Total	0.5	0.9	1.6	2.8	4.7	7.8

*Source: Jupiter Research, September 2000.*

**Exhibit 4**  
**Value Chain for \$100 Pair of NIKE Shoes**

Material Cost	\$15.67
Direct Labor Cost	\$2.59
Administration & Overhead	\$4.56
Factory Profit Margin	\$1.90
<b>Net Factory Price</b>	<b>\$24.71</b>
Shipping, Customs, and Finance Charges	\$3.88
<b>Net Landed Price</b>	<b>\$28.59</b>
Warehousing & Distribution	\$0.76
Royalties	\$0.38
Net Quality Costs	\$0.27
Direct Ship Allowance	\$0.21
Research And Development	\$0.23
Other Costs of Sale	\$0.17
<b>Total COGS</b>	<b>\$30.62</b>
Sales Discounts	\$4.61
SG&A	\$8.29
Corporate Overhead	\$1.75
Interest Expense	\$0.21
Income Taxes	\$2.56
<b>Total NIKE Cost</b>	<b>\$48.03</b>
NIKE Net Profit	\$4.00
<b>Gross Wholesale Price</b>	<b>\$52.03</b>
<b>Retail Costs And Profit</b>	<b>\$47.97</b>
<b>Retail Sales Price</b>	<b>\$100.00</b>

Source: Company documents.