RECREATIONAL EQUIPMENT, INC.: SELLING GEAR TO THE ADVENTUROUS

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Enthusiasts who are impassioned about the outdoors and who regularly buy equipment for their recreational activities are probably familiar with Recreational Equipment, Inc. (www.rei.com), well-known in the world of mass retailing as REI. This consumer cooperative has become a dominant large-scale retailer that many turn to for the latest in equipment and outdoor clothing. It is a proverbial icon in the Northwest and over the last decade has gradually spread its retail locations throughout the United States.

REI sales topped the billion-dollar mark in 2010 at $1,658,751,000 up 14% from $1,455,351,000 in 2009. To place these figures in perspective, total consumer spending on outdoor recreation merchandise in the U.S. was $46 billion in 2006[1]. REI reports that it has approximately 3.8 million members at the end of December 31, 2010[2].

The Outdoor Equipment Industry

REI isn't the only large competitor in the outdoor recreation equipment industry. In fact the industry is somewhat difficult to define because firms choose various competitive strategies to differentiate themselves and to focus on specific target markets. For example, Smith and Wesson is primarily a *manufacturer* of firearms and hunting products. It does not directly compete with a large *merchandiser* like Cabela's or Sportsman's Warehouse. These large firms concentrate on retailing although they also often display some hybrid aspects of backward vertical integration through manufacturing their house brands of hunting equipment. By the same token, mass sporting goods retailers like Foot Locker, The Sports Authority, Dick's Sporting Goods, Big 5 Sporting Goods and The Finish Line pursue a broad differentiation strategy oriented to the mass market for outdoor recreation.

According to a Fall 2006 report "The Active Outdoor Recreation Economy" published by the Outdoor Industry Foundation, consumers spend $730 billion on equipment and participation[3]. Of this market large merchandisers like REI focus on several key components (excluding hunting and fishing) as shown in Table 1.

In addition to the activities listed above, REI also caters to individuals who participate in mountaineering, rock climbing, bouldering, travel and fitness.

The Outdoor Industry Foundation reported that 137.8 million Americans participated in outdoor recreation during 2009[4]. The study noted that in 2009 there were 10.1 billion outdoor outings with 80 percent of the participants indicating that they planned on spending more time partaking in outdoor activities in 2010.

Table 1
Participants and Retail Sales in the Outdoor Recreation Economy

Activity	No. of Participants (thousands)	Gear Retail Sales (millions)
Bicycle-based	58,837	$6,230
Camp-based	45,161	8,676
Paddle-based	23,596	2,668
Snow-based	15,587	3,125
Trail-based	55,834	3,340
Wildlife Viewing	66,100	8,845

REI's main competitors include large retailers like L.L. Bean, Eastern Mountain Sports, Eddie Bauer and Cabela's. Table 2 provides a comparison of these firms on key characteristics drawn from the home pages of each organization's web site (Cabelas.com; REI.com; LLBean.com; theNorthFace.com; Eddie Bauer.com; Patagonia.com; EMS.com)

The business models followed by these firms and similar competitors are as diverse as their product lines and brands. For example, The North Face is a dominant competitor in the outdoor recreation industry. It is both a manufacturer and retailer of equipment. Founded in 1966, The North Face specialized in high-end hiking, climbing and mountaineering gear. For almost three-and-a-half decades it was a direct competitor of REI. Then in 2000 after losing $100 million in 1999 on sales of $238 million, the firm was acquired by VF Corporation[5].

Formerly focused on a specific target market and the limited manufacturing of the highest equipment, The North Face adopted a mass manufacturing and mass merchandizing approach very similar to fashion and apparel strategies of its parent company. This same evolution was mimicked by Eddie Bauer after it was purchased by Spiegel. Admittedly many firms in the outdoor equipment industry have seen their fair share of tough economic times. REI faced stagnant sales in 2000 like many of these competitors. However, customers who were familiar with products from The North Face and Eddie Bauer in the 1960's to 1980's could argue that diminished product quality resulted from affiliation/acquisition with extremely large retailers.

In contrast, a manufacturer and retailer like Patagonia has managed to remain tightly focused on active outdoor recreation equipment. In regards to business models, Patagonia and REI now have very similar price-cost-profit economics. For its part Patagonia diversified its product line and expanded its retailing strategy. REI, in contrast, explored manufacturing during the late 1990's before divesting these business units resulting in greater emphasis on retailing and rigorous business-to-business relationships for its house brand.

Looking simultaneously backward and forward, it is clear that the active outdoor equipment industry has faced, and will face again, a very tough competitive environment. Firms in this industry must balance high quality with low cost in order to capture sizeable market share. Many firms have adopted product diversification to segment the customer market. Fashion trends have gripped the industry and will continue to do so in the future. The day of small specialty manufacturers with a retail presence appears to be precarious. High quality manufacturers tend to be captive by the large retailers who offer a ready market for new gear.

Table 2

A Comparison of REI's Main Competitors

Company	Date of Inception	Total Sales	Geographic Coverage	Brand/ Mission	Product Line
Cabela's	1961	$2.6 billion (2009)	30 stores, catalog + Internet	Leading specialty retailer of outdoor recreation equipment and world's largest direct marketer of hunting, fishing, camping and related outdoor merchandise	Full range of outdoor hunting and equipment, clothing and footwear, fishing and marine, camping equipment, gifts and furnishings
REI	1938	$1.5 billion (2009)	100 stores in 29 states + Internet	Inspire, educate and outfit people for a lifetime of outdoor adventure and stewardship	Full range of active outdoor equipment
L.L. Bean	1912	$1.4 billion (2009)	Freeport, Maine headquarters plus 14 stores in the east and Midwest + Internet	Trusted source for quality apparel, reliable outdoor equipment and expert advice	Full range of sporting goods, home furnishings and casual and active apparel
The North Face	1966	$1.4 billion (2012)	Global market penetration via retail outlets and E-commerce. Growth in China, Asia-Pacific and Africa	"Never stop exploring" via diverse mountain sports equipment and apparel	Full continuum of performance and active sports merchandise in alpine sports, hiking, climbing, running, and yoga
Eddie Bauer	1920	$971 million (2008)	370 stores throughout the U.S. + Internet	Signature outerwear all built to be the best	Outerwear apparel, swimming, footwear, bedding and home, bags and gear
Patagonia	1965	$260 million	Global marketing via the internet, retail outlets and affiliated distributors	Build the best product, cause no unnecessary harm, use business to inspire and implement solutions to the environmental crisis	Apparel and equipment for climbing, hiking, skiing, snowboarding, surfing, fly-fishing, paddling, and trail running.
Eastern Mountain Sports	1967	$105 million (2004)	64 stores in 12 eastern states + Internet	100% passion for outdoor adventure combined with outstanding customer	Apparel, footwear, camping/hiking gear, climbing, biking, kayaking, snow sports, travel

service

REI's Heritage

REI's financial growth is impressive considering its humble Seattle roots that can be traced back to 1938[6]. After two years of operating informally out of their garage, Lloyd and Mary Anderson established a cooperative for their friends to purchase high-quality equipment, such as ice axes, at low cost.

Cooperative organizations are formed by a group of individuals to operate a business for their mutual benefit. The International Cooperative Alliance (ICA) (www.ica.coop) is a non-governmental association representing cooperatives worldwide. According to the ICA, 294 organizations from 94 countries represent interests of more than a billion people. The distinguishing characteristic of a co-op over private enterprises is control of operations and retention of financial gains by the co-op's constituent members who are owners. The ICA web site explains that co-ops are designed to balance the "need for profitability with the needs of members." Co-ops are differentiated from non-profits by the ability to continually earn more than an accounting return on invested assets; that is, a co-op can pursue profits in the interests of members/owners. Co-op members of the ICA in the United States include the National Rural Electric Co-operative Association, National Society of Accountants for Co-operatives, and the Nationwide Mutual Insurance Company.

Table 3
Comparative Differences between Corporations and Cooperatives

	Corporation	**Cooperative**
Focus	A legal entity with the ability to limit liability to the organization and to pursue profits for the owners	A legal entity established to serve diverse needs of a group of people as well as to manage the financial well-being of the group
Ownership	By shareholders	By constituent members
Governance	Independent board representing investors controls management and the organization	Members have voting control of the board, management, and the organization
Profitability	Profits pursued in interest of owners	Profits pursued in interest of members
Return on Investment	Maximized	Pursued along with other interest of members
Earnings	Shared as dividends and stock price appreciation	Shared as dividends

Adopting a co-op charter was a deliberate move by the Andersons who weren't interested in making money off their friends; they just wanted to circumvent high prices that local sporting goods stores charged for quality mountaineering gear. Eighty-two dedicated mountaineers joined the Co-op by the end of 1938. They received a 15.6% dividend on $1,361 worth of goods[7].

From this inspired mountaineering ancestry sprang the "little co-op that could" and ever since things haven't been the same. In 2011 REI had 118 stores in 28 states including all western states except Wyoming. There were two flagship stores; one in Seattle with 110,000 square feet and the other in Denver with over 100,000 square feet. Other stores ranged in size from 10,000 to 95,000 square feet with signature stores at 35,000 square feet. REI also offered customers two on-line venues—REI.com and REI-OUTLET.com—in addition to travel adventure through REI Adventures[8].

Aspiring members of REI can purchase a lifetime membership for $20. Members are eligible for annual dividends which have historically been around 10% of total eligible purchases. Discounted and sale items as well as classes, trips, postage, sales tax, and membership fees generally do not qualify for dividends. Dividends are usually distributed around March of each year. Members can apply dividends to new purchases or, after July 1, receive the dividend as cash. Members may also apply for an REI Visa card which offers an additional 5% back on most purchases.

In 2010 REI was named the top brand according to the Digital IQ® index developed by Professor Scott Galloway of New York University's Stern School[9]. The index measures "site and e-commerce strength, digital marketing and mobile capabilities, social media savvy and search engine marketing and optimization" (Business Wire, 2011). REI was also recognized as "Best in E-commerce Innovation" at the Retail Systems® Achievement Awards celebration in Chicago—a noteworthy accolade[10].

REI was essentially little known outside of the Pacific Northwest during its early years. A wide variety of outdoor gear was merchandised through a few funky warehouse shops and colorful catalogs depicting hauntingly beautiful locations in the Cascades and Olympic Mountains. Catalog and mail order operations began burgeoning from word-of-mouth testimonials. The Co-op expended very little on advertising or promotion, a policy consistent with its cooperative charter. REI's strategic focus centered on delivering high value products to members.

By the mid-1970s REI was headquartered in less than ostentatious facilities. At that time REI's flagship store located on Seattle's Capitol Hill overlooking Lake Union included a nondescript warehouse with storefront. A modest white and green sign quietly proclaimed REI's presence. There were no designer displays, fancy lights, plush surroundings or slick sales associates trying to push the latest gewgaws in outdoor merchandise. In fact, the Co-op developed a reputation for excellent sales assistance from knowledgeable, outdoors-active staff. Mail orders to long-time members were often "shipped and billed" until the use of credit cards expanded.

Seattle's venerable flagship store offered a low-key shopping environment where dedicated aficionados sorted through functional, low cost and high quality equipment. A visit to the mother ship provided wholesome entertainment. A virtual cornucopia of gear waited for members to scrutinize. Equipment was everywhere—in the rafters, tacked to the walls, laid alluringly under glass, hanging on racks and piled in huge cardboard boxes. In many respects the merchandising philosophy at this time was a precursor to big-box chains emphasizing a value proposition.

But, what really made REI hum in the early days were first-rate color catalogs followed by well-informed and intensely focused customer service. While the catalogs in those days were not exquisite by today's high-priced glossy standards, they were extremely informative and comprehensive. Members received two main issues—early spring and late fall—that enticed readers to buy the latest equipment.

Expansion via "B" Level Locations

When a firm offers good quality products at reasonable prices, customers are often attracted like a bear to honey. Consequently, in the late 1970s and 1980s REI began expanding the number of stores located in major metropolitan areas throughout the West. The first store outside of Seattle opened in Berkeley, California during 1975. Initially expansion of retail outlets tended to follow a fairly circumscribed model. Low cost "B" locations were targeted replicating Seattle's flagship store and adhering to the frugal co-op persona. High visibility "A" locations weren't preferred because sales and service centered on members—not the general public or high profile retailing centers that raised the cost structure of operations. REI knew that members would make the effort to find and travel to relatively obscure locations.

Addition of a new store in Albuquerque, New Mexico to the outlet chain illustrated REI's location formula. In 1989 REI unveiled its newest store in the Old Town district of Albuquerque. Mimicking the main Seattle flagship store, a nondescript building had been acquired on a backwater street in a relatively low-rent location. The obvious advantage of this strategy was cost savings. Without the frills and chic ambiance of high-rent locations, REI's policy of acquiring "B" locations enabled it to drive a good bargain for the Co-op's owners (i.e., members) while remaining true to its co-op heritage of serving member interests.

For more than 10 years Albuquerque's store offered a delightful experience for the insiders—REI members—and a novel experience for non-members who stumbled upon the store (non-members could make purchases, but they would not qualify for year-end dividends). Superlative customer service was imperative and this included a liberal returns policy on worn gear if it did not meet a member's expectations. Members found that there was plenty of room to roam in the spacious building. Nothing was cramped. Seldom, if ever, was stock low. Customers could rely on inventory displayed in catalogs being available when they walked through the doors. Parking was not a problem given an expansive parking lot and access was extremely easy since the store was sited a bit off a trendy central tourist area. Thus, it came as something of a surprise when Albuquerqueans learned that REI would be moving. It didn't seem to make sense because nothing was broken—why fix it?

A Shift in Location Strategy

The transition from a "B" location to an "A" location reflected an important strategy shift on the part of REI, and ostensibly a significant change in strategic objectives and mission. The Albuquerque REI store's property was rapidly rising in value due to a concentration of community, cultural and business/economic assets. Old Town was drawing a growing number of tourists and customers to local shops. Traffic dramatically increased and as a result property values rose and with it the terms of the lease for REI. It made financial sense to relocate.

Albuquerque REI members waited with anticipation for the new store's opening at an "A" location alongside Interstate 25. Would there be a climbing wall like Seattle's Flagship store? What new technologies would be incorporated adding pizzazz to the shopping/buying experience? How much larger would the store be in square feet compared to the Old Town store? How many new products would be displayed? Would the range of products approach that of the Seattle store? These and other questions passed through the minds of REI's faithful. Albuquerque was finally going to be on the map as far as availability of outdoor recreation equipment was concerned.

Members who foresaw a significant shift to a bigger, better store in Albuquerque were sadly disappointed. After the new store along I-25 opened, a visit revealed that it was *smaller* than the old store. There seemed to be less room on the sales floor and less stock to select from. The completely refurbished building that REI occupied radiated a trendy veneer. The location was easy to access and parking remained a strong point. But, given the relatively confined sales space it looked like Albuquerque was stepping back a notch rather than moving forward. Welcome to the new—corporate—REI.

REI was progressively relinquishing "B" locations in favor of high visibility "A" sites that could drive up sales. High profile locations were one manifestation of REI's aggressive new stance. Who could deny that the new Albuquerque store increased REI's public visibility given its location along heavily traveled I-25? But, was this a good move as far as Co-op members are concerned? Facility and location costs went up substantially in exchange for less space. These and other outcomes from REI's strategy shift awaited Co-op members. REI was transitioning into an aggressive corporate retailer bent on growing market share. Choice of real estate was only one aspect indicative of rapid expansion at REI.

Evolving Corporate Strategy

Beginning in the late 1990s, REI diversified its product line to include additional outdoor sports instead of emphasizing a relatively narrow range of mountaineering, backpacking, camping, bicycling and canoeing equipment. It cultivated multi-sports and cross-sports emphases consistent with trends in consumer interest toward more diverse outdoor activities. This shift coincided with a widely pervasive fashion trend of the time—outdoor equipment became urban chic. Suddenly it was cool to be dressed in sophisticated parkas and rugged clothing that might never see a trail or mountainside. Clod-hopper boots conveyed a self-reliant persona and counter culture snub to fashionistas. Demand for REI retail outlets exploded.

At the same time the Co-op eliminated membership as a requirement for customers to purchase goods. This policy revision symbolized an important shift from focusing on *members* participating passionately in a relatively narrow range of outdoor sports to *customers* partaking infrequently in a wide variety of sports. This also reflected a fundamental philosophical change in how to do business.

In the late 1990s, REI Corporate (located in Kent, Washington) modified its strategy. REI went through a corporatization phase seemingly running counter to its fundamental co-op mission. The board and senior managers were progressively driving REI toward industry dominance and financial gain[11]. As Dennis Madsen, former president and Chief Executive Officer (CEO) of

REI, stated in 2004, “REI is as profit-driven as any other business would be, whether private or publicly traded”[12]. A manufacturing acquisitions strategy was fully underway coupled with an infusion of new senior leadership. REI began to act more like a for-profit corporation intent on building market share and profitability than a cooperative intent on serving its membership.

The Co-op was now flexing its muscle as a mass market manufacturer and merchandiser. Vertical integration began to surface in decisions about store locations, inventory management, multi-channel shopping and procurement, among other important business practices. In many respects the term “cooperative” became a platitude, a veil to hide behind while REI was morphing into a corporate entity.

For a period REI was headed toward becoming a leading manufacturer of outdoor products. In 1997 about 30 percent of the goods REI sold were manufactured by its own subsidiaries. REI had acquired small U.S.-based manufacturing firms capable of producing goods that yielded high profit margins[13]. The Co-op purchased small manufacturers such as Mountain Safety Research Corporation (MSR), a leading outdoors research and development firm based in Seattle spinning off new backcountry equipment. MSR pioneered innovations in backpacking stoves, snowshoes, tents and water filters, among other products. REI also purchased Moss Tents and Walrus Tents.

The acquisition of small manufacturers didn’t last very long due in part to market trauma associated with September 11, 2001. As REI’s financial performance floundered it divested the small manufacturing subsidiaries in exchange for a healthy influx of capital. MSR is now a subsidiary of Cascade Designs, the maker of Therm-a-Rest® mattresses. THAW, another REI subsidiary purchased in the 1970s from REI principals was also sold off[14]. Eighty percent of THAW’s $40 million business in 1996 was dedicated to REI.

The exact nature of REI’s continuing relationship with divested subsidiaries was not readily available public information. The extent to which past or present REI management and governing board members were involved in ownership or management of the divested entities is unclear. However, former president and CEO Dennis Madsen disclosed that he was a board member of THAW Corporation, Mountain Safety Research and Edgeworks, Inc. (a tent manufacturer)[15]. Whether long-term procurement/sales contracts existed between the divested entities and REI was also unknown.

Prior to divesting the manufacturing entities, REI’s strategy was leading it toward vertical integration. No longer just a buying cooperative, REI was on course to significantly control its supply chain and market through integrated retailing and manufacturing enterprises. Continuing on this path, REI could possibly have achieved sufficient clout to affect—some might go so far as to say, determine—the industry’s composition. Survivability of small mom-and-pop retailers and small products manufacturers could hang in the balance.

REI Albuquerque

Virtually all REI retail outlets had a significant impact on small, specialty outdoors retailers who often served customers for years, catered to their special needs and developed unique bonds with local communities. Again, the arrival of REI in Albuquerque in 1989 as REI’s 18th store served as an excellent case in point.

Co-op members in the Land of Enchantment were pleased about REI's decision to locate a new store along the Rio Grande. They avoided shipping costs, had products at their finger-tips for first-hand scrutiny, and access to a wider selection of equipment. But, as with most good things in life, there was a cost. REI outlets often had a deleterious effect on local competition.

At any given moment in the early 1990s Albuquerque counted four specialty retailers with product lines emphasizing mountaineering, hiking and backpacking. Big box sporting goods retailers also operated in Albuquerque at this time, but the breadth of their product lines seldom cut into the small retailers. The big boxes sold discount gear while the small specialty retailers offered high-end quality gear for people who often encountered extreme conditions.

Within two years after REI opened its doors, two of the four small specialty retailers closed up shop. After three years only one small mountaineering retailer was doing business. It continued for seventeen more years before it too gave up. Throughout this period the population of Albuquerque steadily expanded. Any recessionary trends were generally balanced by population growth.

Competitive Impact

The preceding scenario has often repeated in communities where REI decided to build new stores. Highly creative and customer-savvy smaller retailers devised strategies to counteract the presence of biggie-sized retailers like REI. But the competitive battle was wearing. The parallels to retailers who go up against the likes of Wal-Mart and other retailing giants were obvious. However, most REI members probably did not think about how their shift in buying behavior put small mom-and-pop stores out of business. Consumers think primarily of their wallets—until they want brand and product diversity.

In 2010's virtual marketplace small retailers were challenged. Consumers could access a full range of products over the World Wide Web. They did not need local specialty stores with high prices (whose margins were necessary for these small stores to survive) and idiosyncratic merchandising proclivities. In this sense REI was not the sole culprit in the demise of the cottage industry for outdoor goods.

With the corporatization of REI there was a noticeable change in product brand availability. Customers typically had difficulty finding a broad selection of truly high-end equipment brands at REI stores or its on-line website. There was a smattering of high-end products (typically at suggested retail prices) from specialty manufacturers like Patagonia, The North Face, Marmot and Mountain Hardwear. Their products were apparently there to mask the fact that REI preferred to sell middle-grade products, ostensibly REI branded products with higher margins. This deliberate strategy intensified as CEO Sally Jewell indicated that she wanted to turn REI's in-house brand into a premium brand[16].

By 2010, outdoor manufacturers' product lines had expanded to the point that it was economically infeasible to carry everything offered by every brand. But, REI had consciously adopted the strategy that it would carry relatively few non-REI brands. Consequently, there was almost no true brand diversity. If members wanted a specialty piece of equipment from a non-

REI source, they had the option of submitting a special order. But, they were stuck with the product when it arrived whether it met their expectations or not.

Like most contemporary firms, REI was striving to hold down inventory costs by simulating just-in-time delivery to customers. For all intents and purposes most REI stores had limited stock on their shelves particularly in the most popular sizes. This was a deliberate move. The less money REI had invested in inventory the better its financial performance, as long as virtual inventory kept turning over.

REI makes money from *selling* products. If it doesn't take ownership of a product until the very last minute—after an order has been placed and cash received—then it has kept its carrying and tax costs to an absolute minimum. This often was less convenient for customers because they had to wait for a product to be delivered. Businesses using this strategy rationalize that customers do not wait very long for an order to be delivered.

From a customer's perspective there were more costs to this strategy than just the price of the product. The immediate cost was no product available to physically examine for fit and finish. For example, if you wanted to buy a wind-block fleece jacket, the odds favored that such a jacket by The North Face in your size would *not* be on the rack at REI. With luck, other North Face sizes in that jacket were available so that you could feel and examine the jacket. But, you could not determine whether a size medium, large or extra large offered the best fit. You had to approximate and wait until the jacket arrived to determine this.

In addition to the dual costs of not having a product available for inspection and waiting for it to be delivered, there were the onerous costs of either paying to have the product delivered to your door or driving to an REI store and picking it up. Customers—the very members upon which REI existed—paid for REI's inventory policy. A counterargument was that by keeping inventory costs low REI was able to produce a large dividend. That rationale may be specious since REI routinely (except in the year 2000) derived enough profit to allocate a ten percent dividend *and* to reinvest within the corporation.

With a new inventory policy in place, REI essentially gave members the incentive to go shopping for high-end brands. Competitor retailers usually offered the same goods as REI at discounted prices. Normally the discount savings were sufficient to make up for any lost REI dividend. In many cases other retailers offered low or no cost shipping. In this respect the marketplace was working efficiently. Well-experienced consumers took full advantage of this fact. They shopped at REI to touch and try-on a product (*if*, REI had it in stock), and then they went on-line and shopped for the best deal. In this respect, REI had inadvertently encouraged consumers to buy at non-REI sources.

REI eventually changed its in-store order and delivery policy. Customers could now order products and have them delivered to an REI store free-of-charge. This certainly worked for those that lived near a store, but what about members for whom this was not an option? These members had to explore the marketplace. This stance seemed counter to that of a co-op concerned about serving its members. An aggressively innovating organization intent on being lean and mean would not ignore these customers. One option would be to devise a strategy that reduced shipping costs to members who lived more than a pre-specified number of miles from any REI store.

Human Resources and Executive Management

In 2011 *FORTUNE* magazine heralded the fact that more than 8,640 people worked at REI in a casual and relaxed environment[17] (REI's website in 2011 also alluded to other employment figures such as 9,000 employees and 10,000 employees). For 14 consecutive years, *FORTUNE* magazine has recognized REI as one of the 100 best companies to work for in the U.S. In 2011, the company ranked number 9 and in 2010 REI ranked number 14 behind number 13 W.L. Gore & Associates and ahead of number 15 Zappos.com. Several special employee perks helped earn REI this distinction: a comprehensive benefits package, discounts on REI merchandise, paid sabbaticals, incentive pay, and opportunities to use REI brand gear. *FORTUNE* magazine also lauded REI's strong promote-from-within policy.

REI's website offered a 2009 "Stewardship Report" on community, environment and people[18]. Included in this report were the annual employee survey results on dimensions such as employee engagement, retention, and diversity. The 2009 survey indicated that 85% of all employees provided feedback and that their index of employee engagement was very favorable at 87% (100% is the highest index score).

A total of 97% of the respondents indicated that "I fully support the values for which REI stands." The lowest ranking among the employee engagement metrics was 70% for "It would take a lot for me to look for another employer." Thirteen percent indicated agreement with "At the present time, are you seriously considering leaving REI?" Clearly high percentages of REI employees viewed the workplace as attractive due to equipment/gear discounts, health care benefits, incentive pay, a retirement plan, and promotion of work/life balance.

Based on the 2009 report, the average REI employee worked part-time (63.9%), was male (57.1%), and White (87.0%). Of all employees, 1.8% were Black/African American; 5.4% were Asian; 4.1% were Hispanic; 0.5% were American Indian/Alaska Native; 0.1% were Native Hawaiian/Pacific Islander and 0.8% were two or more races.

An independent web site provided further insights on REI's work environment and culture[19]. As of March 1, 2011, 65 REI employee reviews of REI's workplace environment were registered at Glassdoor.com. The overall score on a five-point scale for satisfaction by these respondents was 3.8 or "satisfied." Caution should be used in interpreting these findings since only 0.6% of all REI employees used the web site. Furthermore it is not clear that all respondents are valid REI employees (or former employees).

The positive aspects of working for REI noted above were reinforced by the comments of these respondents. However, the "con" side of working at REI was given a little more light assuming that these commentaries were valid. Respondents noted the following concerns:

- Limited work hours are available (It's hard to get the hours you want, especially if you want full-time work).
- Employees are pushed too hard to secure new members.
- Perks fade over time.
- Store managers hire newer (lower wage) employees and give senior (higher wage) employees fewer hours to keep costs down.
- Management is based too much on tenure.

Respondents also chided REI for creating a "membership cult" while at the same time acting more like a corporation than a co-op.

REI had adopted a strategy of reaching inward to draw up senior management. This was normally an excellent strategy for maintaining employee loyalty and reinforcing a dominant organizational philosophy and mission. But, it can come at the cost of innovation and creativity. In-bred organizations are susceptible to the myopia of group-think and are less cognizant of significant shifts in the marketplace. Consequently, promoting leaders within an organization like REI may tend to perpetuate the status quo.

REI has made progress in going outside corporate walls to bring in executive talent but it has been costly in terms of executive compensation. In 2000 Sally Jewell, a former Washington Mutual executive, was hired as Chief Operating Officer (COO). Jewell, who earned $1,311,941 in 2006, served as COO before taking over in 2005 for Dennis Madsen who earned $1.3 million in his final year as CEO and president of REI[20]. According to REI, in 2010 Ms. Jewell earned total compensation of $2,281,764, up 60% over 2009 ($1,426,592)[21]. Matt Hyde, Executive Vice President earned $999,975 in total compensation in 2010. These salaries were probably more representative of executive remuneration in corporations earning over $1 billion than being representative of nonprofit and cooperative organizations.

REI's Primary Spokesperson

As CEO, Sally Jewell had progressively served as lead spokesperson for REI. In many respects she exemplified REI's persona—mission-driven, precise, physically-fit, intellectually-vibrant, politically-correct, and positive in her outlook. She seemed to be consistently popping up in the media. At the end of 2010 as Board Chair for the Initiative for Global Development, she participated with 100 CEOs in discussions about increasing investment in Africa. In April she received an Inaugural Outdoor Industry Association Advocacy Leadership Award. In May 2011 she introduced President Obama at the White House as part of the Administration's Great Outdoors Initiative[22]. That same month she also made news headlines in New York at the opening of two stores in Carle Place and Yonkers. She provided the keynote address on the 2009 State of the Rockies Symposium. She was a longstanding regent of the University of Washington. She was a board member and Vice Chairman of the National Parks Conservation Association and she was named "Executive of the Year" in 2006 by the *Puget Sound Business Journal*. These and many other accolades helped to promote not only Sally Jewell, but REI as well.

Sally Jewell was not the first CEO at REI to gain national prominence. Jim Whittaker was the first American to summit Mount Everest in 1963. Whittaker subsequently served as president and CEO of REI from 1971 until 1979. During that period Whittaker was constantly in the spotlight more often for his famous mountaineering exploits than the growth of the Co-op. In fact, at that time REI was still a fledgling enterprise with only a handful of retail locations in Seattle, Portland, Berkeley, and Anchorage. Nonetheless, REI benefitted from Whittaker's public visibility.

In Sally Jewell's case the issue of image enhancement was somewhat the reverse compared to Jim Whittaker. With respect to Whittaker, celebrity status resulted from his personal mountaineering conquests and REI enjoyed the spillover from Whittaker's prominence. In Jewell's case, public visibility resulted from her capable management of an organization with over a billion dollars in sales. REI's success—resulting from Jewell's proficient leadership—helped to create and reinforce her star status.

Fiscal Performance

Insights to REI's corporate leanings were apparent in audited financial statements—consolidated balance sheets, liabilities and members' equity and income and retained earnings—available from REI, Inc. A request to reprint these statements in this case was not approved by REI and no reason was given for this decision. These data are published at REI's website[23]. The following summary drawn from the audited statements provides a solid overview of the firm's fiscal performance. Please note that REI reports data on a calendar year basis ending December 31.

According to audited financial statements available at the REI website, net sales in 2010 were $1,658,751,000 which was a 14% increase over net sales in 2009 at $1,455,351,000. Net sales in 2008 were $1,434,569,000, thus REI had seen a total two-year sales increase of 15.6%. It appeared that REI prospered significantly in 2010 coming back from a modest 1.6% sales increase in 2008-2009. Factoring in the general economic recession, many firms would be pleased with a single-digit sales increase due to the lack of consumer demand. From this perspective, rising sales at REI were very impressive. It appears that REI was recovering quite well in terms of profitability after the dot.com fiasco, terrorist impact, market suppression and recent economic recession.

REI's consolidated statements of income indicated that in 2010 the total cost of sales was $929,787,000 which created a gross profit of $728,964,000 while the 2009 total cost of sales was $804,834,000 with a gross profit of $650,517,000[24]. REI's total cost of sales from 2010-2009 grew slightly more at 15.5% than did net sales at 14%. REI's gross profit margin in 2010 was 43.9% and 44.7% in 2009. Total operating expenses in 2010 were $613,527,000 creating an operating income of $115,437,000 while total operating expenses in 2009 were $100,560,000. Patronage refunds in 2010 were $79,848,000 and $67,222,000 in 2009. After taking taxes into account, REI's net income was $30,230,000 in 2010 and $29,807,000 in 2009.

Respectively for 2010 and 2009, the operating profit margin is 7.8% ($129,627,000/$1,658,751,000) and 7.9% ($114,570,000/$1,455,351,000) thereby indicating regained stability in operating profit. Respectively for 2010 and 2009, the net profit margin for REI was 1.8% and 2.0% respectively. These modest net profit levels must be considered in light of the large member dividends distributed by REI. The net profit margin for 2008 was down to 1.0% which probably reflected the severe economic crash. The rising net profit margin also indicated how strongly REI had bounced back from the recession during the last two years.

All-in-all, the profile that emerged for REI on the income and operational expense side was quite impressive. It had managed to increase sales in a very down market while controlling costs. REI had continued to deliver a Co-op member dividend around 10% on net sales despite falling sales growth. Note that total patronage refunds do not incorporate refunds on discounted sale items, sales to non-members, or goods that do not qualify for dividends. This explained why the percentage of patronage refunds(net) to total net sales was only 4.8% in 2010 ($79,848,000/$1,658,751,000) and 4.6% in 2009 ($67,222,000/$1,455,351,000) despite REI's heritage of giving back to *members* an average 10% refund. Although figures disclosed in annual reports vary, somewhere between 20-30% of all sales were to non-members and hence not qualified for dividends.

In 2010 and 2009 REI did not pay federal or state taxes on approximately $79 million and $67 million respectively in "patronage refunds." There were specific federal tax advantages to operating as a cooperative under Subchapter T. Cooperatives generally do not pay income tax on surplus earnings—patronage dividends commonly known as patronage refunds—that are refunded to members. Members must report these refunds in their taxable income but a question could be raised regarding just how many members declare their refunds as taxable income.

REI's consolidated balance sheets reflected a very solid fiscal foundation. Of $681,261,000 in current assets during 2010, 51.7% ($352,447,000) were cash, cash equivalents or securities and 38.2% ($259,961,000) were inventories while the remainder were accounts receivable of $16,153,000, less doubtful accounts ($53,000,000), deferred income taxes of $41,196,000, and prepaid and other expenses of $11,504,000. By comparison, current assets in 2009 ($528,991,000) were 22.4% lower than in 2010 with cash ($261,476,000) and inventories ($202,983,000) comprising 87.8% of total current assets (versus 89.9% of total current assets in 2010 comprised of cash and inventories).

REI reported $1,062,374,000 in total assets and $366,609,000 in property and equipment in 2010 compared respectively to $919,911,000 and $368,085,000 in 2009. Property as a percent of sales was 22.1% in 2010 and 25.3% in 2009 significantly up from prior decades. Back in early 1990 when REI pursued "B" locations, it demonstrated greater efficiency (in those properties) as far as generating sales. At the same time the Internet was just taking off. Now some 20 years later, REI had *both* the real, tangible, properties to generate sales *and* the Internet.

By any measure, the large cash and cash equivalent accounts for REI in 2010 and 2009 spoke volumes about REI's strategic options. In 2010 33.2% of total assets were liquid while in 2009 28.4% of total assets were cash or cash equivalents. This gave REI significant latitude as it looked to the future whether for expansion, addressing competitive forces, or improving operational functions. If REI was publicly traded it might be susceptible to a take-over by a firm that wanted to raid this particular market and/or take advantage of REI's attractive chest of liquid assets. In a corporation an issue could be raised about how the entity intended to expend such a high cash surplus. Expansion through new investment or acquisitions is typically the answer. Shareholders (if there were any) would also argue that they deserve a portion of these current assets via dividends. Corporations have the option of using the huge cash and investments to pay down existing long term debt. REI did not list long-term liabilities other than memberships and retained earnings.

Another significant aspect of REI's balance sheet was inventory. Inventory as a percent of total assets for REI was calculated at 24.5% in 2010 and 22% in 2009. In 2010 inventory as a percentage of sales was 15.7%, up slightly from 13.9% in 2009 and 14.4% in 2008. These inventory ratios underscored REI's attempts to keep inventory investment at a low level. Although data for the average inventory were not available, the stated inventory level from the balance sheet can be used as a proxy to compute inventory turnover. The inventory turnover ratio for 2010 was 4.02 and for 2009 was 3.97. Compared to other retailers REI was doing very well. For example, Cabela's 2010 inventory turnover ratio was 3.0 and in 2011 Dillards' was 3.1.

Against this favorable portfolio of total assets, attention should be given to REI's liabilities, most of which were current. Of $474,431,000 in total current liabilities in 2010 ($378,640,000 in 2009), three major categories represented 65% (63.2% in 2009) of this total: $117,019,000 ($79,087,000 in 2009) in accounts payable, $100,438,000 ($84,079,000 in 2009) in customer related obligations, and $90,942,000 ($76,295,000 in 2009) in patronage refunds payable (REI Financial Statements, 2011). The remainder of current liabilities in 2010 ($166,032,000) and 2009 ($139,179,000) were spread among REI Visa rebate payable, accrued payroll and related benefits, retirement and profit-sharing liabilities, business taxes and other accrued liabilities, and income taxes payable.

Most significant was REI's virtually zero long-term debt. REI only reported $54,098,000 in deferred rent and other long-term liabilities in 2010 ($53,517,000 in 2009), with total members' equity of $533,845,000 ($487,754,000 in 2009) (REI Financial Statements, 2011). Thus, REI had substantial flexibility relative to borrowing for strategic options. Without sizeable long-term debt and benefitting from modest current obligations, REI was well positioned to fulfill its heritage of generous Co-op member rebates while continuing to expand operations.

Strategic Implications from Fiscal Performance and Economic Forces

Considering the turmoil that confronted the U.S. and international economies, REI's top management and board should be congratulated on weathering a very difficult period. The Co-op was in excellent financial shape as of 2010 and was positioned to meet competitive threats. REI went through a period of rapid corporate-style growth until it hit recessionary forces in 2000 and then again in 2008. Early acquisition of small manufacturers may have been well-intentioned as a way to raise profitability by controlling the production of high margin goods, but this strategy conflicted with the Co-op's heritage and mission.

Economic softening in 2000 may have been sufficient to cause top management and the governing board to reassess what they were doing and where REI was headed. The divestiture of small manufacturing entities coincided with a healthy cash inflow. By 2010 REI focused on providing a multi-channel shopping experience, predominantly oriented to the roughly 4.0 million Co-op members, through the Internet, mail order, e-tailing (electronic retailing), phone, and bricks-and-mortar. Insightful critics could argue that it is not difficult to succeed when customers have the right frame of mind *before* they enter one of these channels. REI members are fanatical about their sports and as Co-op members loyal to REI. In essence they are already sold before they come through the (channel) door.

From a Co-op member and organizational mission perspective, REI's return to targeted retailing after 2000 was very important. REI's $1.658 billion in sales made it a very dominant player in the marketplace. Via its procurement decisions, the Co-op had the clout to drive out small retailers and to determine the survivability of manufacturers. Is this what members wanted from REI—the ability to shut down small mom-and-pop mountaineering/backpacking stores and small specialty manufacturers that were innovating with new and improved products? REI members loved their patronage dividends, but did they want them at the expense of harming the cottage industries (i.e., retailing and manufacturing) in mountaineering, canoeing, backpacking, biking, skiing and other popular outdoor sports? An answer to this question was difficult to derive. However, it did not appear that many Co-op members walked away from their dividends or membership.

Finally, from 1976 until 2009 REI had contributed $29 million to outdoor recreation clubs and conservation groups. Giving was restricted to communities in which REI did business[25]. REI increased its financial support of environmental stewardship efforts to $3.5 million in 2007 (up from $3.0 million in 2006)—in line with its policy of giving three percent of operating profit. Contributions registered $2 million in 2009 down from $3.7 million in 2008. Some would argue this is not very generous considering that REI's gross sales exceed $1.4 billion dollars in 2009 and considering that REI had more than a quarter of a billion dollars in cash. By comparison Patagonia, Inc. pledges "at least 1% of sales to the preservation and restoration of the natural environment" while encouraging other corporations to become members of the 1% for the Planet Alliance[26]. Given Patagonia's rule of thumb, REI's annual environmental giving should have been more on the order of $14.5 million; or seven times higher for 2009 than reported.

In addition to modest financial contributions, REI was relatively uninvolved in highly visible environmental battles. The Co-op was seldom a leader where significant conservation initiatives were concerned. On the one hand, it could be argued that REI's passive stance on environmental and conservation advocacy reflected negatively on senior management, the board and Co-op members. On the other, REI's mission and charter appeared to preclude such advocacy. In this sense, by remaining focused on running the Co-op, REI's leaders gave back to members exactly what was intended when the Co-op was originally established—high quality equipment at low prices.

On its web site REI alluded to the REI Foundation but it did not clearly explain what the Foundation was, how/why it was started, and how it related to REI, Inc. The REI Foundation (EIN: 911577992; a company-sponsored foundation) was established in 1993 in Washington state. According to REI's web site the Foundation supported programs that inspire the next generation of outdoor enthusiasts and environmental stewards, especially those from diverse populations.

In 2009 the Foundation supported three major projects with the National Audubon Society ($110,000), the NYC Green Stops Partnership ($100,000) and the EarthTeam Environmental Network ($14,000). The Foundation received $1,706,669 in gifts during 2009. It has assets valued at $7,520,370 and in 2009 distributed $238,775 for 12 grants (high: $110,000; low $10,000). In 2008 it made one grant of $25,000 to Outdoor Outreach in San Diego, CA.

A Strategic Vision for the Future

By 2010, Sally Jewell, the executive team and board of directors were probably proud of REI's accomplishments during their turn at the helm. Although it is difficult not to conclude that the Co-op was doing many things right, the leadership team may have been raising questions about what REI could do better? Several issues needed to be considered as REI formulated a strategic vision for the future:

1. How had economic trends affected competitors in the outdoor equipment industry on the retailing side and what did these trends imply for the backward vertical integration strategy REI was following?

2. How well had the Co-op performed financially and what had been the strategic and operating implications of this fiscal performance?

3. How could REI members and customers benefit by having a greater breadth of products available through all of REI's sales channels?

4. As REI looked to its future and further market penetration, should more attention be directed to serving Co-op members' and customer needs rather than serving corporate aspirations?

5. Instead of pursuing national market penetration through bricks-and-mortar, should REI invest more effort in fulfilling its co-op legacy through diverse retailing options?

6. Should REI become more active in advocating for environmental issues?

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