

Is Lululemon Athletica's Turnaround Sustainable?

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lululemon athletica, Inc. was founded in 1998 by Chip Wilson with a focus on comfortable, innovative athletic wear for women dedicated to a healthy, fit lifestyle. The company went public in 2007 and has been plagued with product and management issues ever since. Expected revenues for the future have been revised downward and growth in the women's apparel industry is predicted to be -0.4% in the next five years. Can lululemon athletica, Inc. survive? While it has increased its gross revenue in the last two fiscal years, has it turned the corner on past mistakes?

INTRODUCTION

Chip Wilson founded lululemon athletica, Inc. in 1998 and grew the company into a popular yoga apparel business. It became known for its high-quality yoga pants that sold for as much as \$98. Celebrities such as Reese Witherspoon, Gisele Bundchen and Kelly Ripa became fans of this brand and lululemon found its upscale merchandise becoming a fashion trend (Thompson & Peters, 2015). Trouble began in 2006 and by 2014 yoga students began to turn on lululemon. Issues have plagued the company off and on ever since. In January 2014, Laurent Potdevin began his work as the new CEO and major challenges awaited him: developing a better supply chain, product quality issues, re-engaging core customers, and delivering growth (Warnica, 2014).

A poor start in the first quarter of 2017 made investors, experts, and investment advisors wonder if the company would rebound or if it will follow the way of other retailers – declining sales, closing stores, and losing the confidence of investors. The company finished Fiscal year 2017 with a 17% increase in gross revenue but with decreases in gross operating margins and net income. However, they opened new stores, are in 12 different countries, and are developing new fabric for women's clothes and bras and men's workout gear (lululemon 2018 10-K; lululemon website 2018).

PAST PRODUCT ISSUES AND SOME CURRENT SUCCESSES

In 2006 lululemon athletica was selling bags in its Vitasea line that were made of seaweed fabric. They claimed that the fabric released amino acids and vitamins onto the skin that reduced stress to those carrying the bag. A 2007 New York Times investigation found that the fabric contained no seaweed, it was made of cotton, and the claims about reducing stress were false (Suddath, 2013; Thomas & Peters, 2015). This event was followed by issues with bleeding colors in its products (Suddath, 2013).

lululemon also sold bags with inspirational quotes on the outside. However, in 2008, when customers washed the bags they discovered non-inspirational quotes underneath the top layer of text. A covering was stitched over the offensive language and when that did not stop customer complaints the company removed all the bags from the stores (Thomas & Peters, 2015).

In 2010, the company had to pull a line of reusable shopping bags when it was discovered they contained lead (Suddath, 2013). The company again received bad press in 2011 when an employee who murdered a co-worker at a Washington D.C. area outlet store went to trial and the jury returned with a guilty verdict (Thomas & Peters, 2015). In 2012 a line of swimwear that became see-through when the fabric became wet was withdrawn (Suddath, 2013).

The year 2013 started out well with the company ranked as #21 on Fortune's Fastest-Growing Companies list. However, by March an issue with product quality made headlines (Kowitt & Leahey, 2013). Manufacturing of products had been moved from Canada to Taiwan to reduce costs. The manufacturer had met lululemon's fabric construction metric tests and began making and shipping products. When store managers received the pants, they raised concerns when they noticed the stretchy black yoga pants made of thin and see-through Luon fabric. An executive director of a community fitness program contacted lululemon when her husband noticed the transparent yoga pants on women who came to a fitness center he worked at in Winnipeg, Manitoba (Suddath, 2013; Thomas & Peters, 2015). Customers were outraged and began speaking out on review blogs, fan sites, and even the invite-only Facebook page (Suddath, 2013). lululemon managers noted that the quality control part of the company was not growing as quickly as the company and that appropriate infrastructure had not been developed. When Kathryn Henry became Chief Information Officer in 2010, she noted the technology support systems suited a much smaller company than lululemon (Kowitt & Leahey, 2013). The company offered customers full refunds for the pants and pulled the pants from store shelves. This was expected to cost the company an estimated \$60-67 million and affected about 17% of the company's black yoga pants stock (O'Connor, 2015). The company was able to get the Luon products back into stores within 90 days. To add to the quality issues, in November 2013, Founder Chip Wilson blamed the transparency problem on the size of women's thighs, stating "Quite frankly, some women's bodies just don't work for [the pants].... It's really about the rubbing through the thighs, how much pressure is there over a period of time" (Dockterman, 2013; Leahey, 2013). A week later, and after much negative reaction from women, Wilson released a video on the lululemon Facebook page apologizing for his statements.

The comments about women's bodies brought to light Wilson's philosophy that yoga clothing is only for skinny people. In a 2005 interview, Wilson noted that plus-sizes take 30% more fabric to make and he would need to charge higher prices for these products to cover costs. This could result in lost sales and loyal customers. The company does discourage plus-size customers with size 12 being the largest size of products sold. In 2011, an NPD group noted that the average dress size for American women is a 14 which is considered a plus-size. At that time, the \$19.4 billion women's plus-size clothing sales accounted for 18% of the total women's apparel market (Dockterman, 2013).

Another product issue occurred in 2015 when lululemon was forced to recall 318,000 women's tops being sold in the U.S. and Canada. The US Consumer Product Safety Commission found at least 20 styles of jackets and hooded tops had elastic drawstrings at the neck and deemed the products hazardous. The recall notice stated, "When the elastic draw cord with a hard tip in the hood or around the neck area is pulled or caught on something and released, it can snap back, impact the face area and result in an injury" (O'Connor, 2015).

Recently the company introduced new clothing and bra material for indoor, high impact, high intensity workouts for women (2018 10-K report). For men they are aggressively expanding their ABC pants to include slim and jogger styles. All the men's fixed waist bottoms now feature their ABC construction. The message in their January 28, 2018 10-K was to continue to develop a strong pipeline of innovation and product rollouts in 2018 (2018 10-K report).

THE MANAGEMENT ISSUES

Chip Wilson founded lululemon in 1998 after selling his surf, skate, and snowboard clothing company. He loved yoga and after seeing what women were wearing in yoga classes he wanted to offer an alternative to the current clothes available: poorly fitting T-shirts and women's fitness clothes that were made by cutting down the sizes of men's styles. The fashion styles along with the seamless stitching and breathable fabrics caught the attention of women and the company grew quickly. Wilson was a control freak who hated 'mediocrity', and as founder he oversaw all aspects of the company and insisted that lululemon would operate its own stores to ensure control and infusion of the company culture (Brown, 2016). However, the 'control' aspect of Wilson's personality clashed with the fast growth at lululemon (Kowitt & Leahey, 2013).

To help him run the business, Chip Wilson hired family and neighbors. With the advent of going public in 2007, along with the need to have a CEO who had the skills to handle the fast growth, the company began looking for a new leader. Christine Day, who had just left Starbuck's, was hired in January 2008 as EVP of retail operations and was promoted to CEO six months later. As she tried to realign the business to match Wilson's original vision for the company, she sent three original employees (all friends) to executive business programs for training. Wilson's sister-in-law, Susan Conrad, ran the company's leadership development program. Wilson's son was creative director for the men's line of clothing (Kowitt & Leahey, 2013).

In 2010, with Christine Day fully ensconced in the CEO position, Wilson became the chief innovation and branding officer – a new position at the company. In 2012, Wilson stepped down from this position, moved to Australia, and took a four-day board governance course to become a better chairman. Employees reported that Wilson would zoom in and out of the company which created confusion about who was in charge. There was a lot of tension among the top managers. The working relationship between Wilson and Day deteriorated and it is reported that they had difficulty coexisting. Wilson admits that he was doing a mediocre job being an employee and being a chairman. In 2013, shortly after the transparent yoga pant recall, Christine Day submitted her resignation (Kowitt & Leahey, 2013).

With a 30% drop in stock, in-store sales declining, a major product recall, embarrassing comments about women, and loyal customers concerned about product quality, the board ousted Chip Wilson and hired a new CEO. Wilson was forced into an agreement with Advent International (a private equity investor), who acquired about 50% of his ownership in lululemon), signed a two-year nondisparagement agreement, and gave up his board seat (Brown, 2016). Wilson retained a 15% stake in the company which allows him to still be involved (Brown, 2016; lululemon Company Profile, 2016). The Board then hired Laurent Potdevin, who had served as President of Tom's Shoes from 2011-13 and worked at Burton Snowboards, Luis Vuitton, and LVMH. Potdevin faced several challenges: developing a company infrastructure especially focusing on cleaning up quality issues, re-engaging core customers, and growing the company (Warnica, 2014).

Potdevin hired Stuart Haselden as Chief Financial Officer to oversee the supply chain. Haselden instituted practices to enforce timely orders of materials, enforced stricter testing at factories, and oversaw the supply chain. Potdevin also grew the men's line by adding more male 'educators' in the stores and recruited more male 'ambassadors' – local trainers, coaches and yoga instructors who promoted lululemon. By 2016, total revenues exceeded \$2 billion and men's clothing sales grew 20% over a three-year period. Although still a large shareholder in lululemon, Chip Wilson moved on to provide advice to a rival clothing company called Kit and Ace, a company that his wife and son founded (Brown, 2016).

Senior management turnover continued in 2018 when Laurent Potdevin resigned February 2, 2018 and the CFO, Stuart Haselden, was replaced by Patrick Guido on April 16, 2018 (2018 10-K report with amendments).

COMPANY HISTORY

lululemon athletica, Inc. was founded in 1998 in Vancouver, B.C. by Dennis ‘Chip’ Wilson. The company began as a design studio by day and a yoga studio at night. The company’s first stand-alone store opened in November 2000 in Vancouver, B.C. Canada. It first began offering yoga-inspired apparel company for women and then added men’s and girl’s lines of products. The company’s core values are: quality, product, integrity, balance, entrepreneurship, greatness and fun (lululemon website, 2018).

Chip Wilson was obsessed with fitness and self-improvement. In 1980, he founded Westbeach Snowboard, Ltd which sold surf, skate and snowboard verticals. He sold Homeless Skateboards, a division of Westbeach, to a Japanese buyer in 1997 prior to opening lululemon. The company name – lululemon -- has no meaning, but he desired a name that had as many Ls as possible. This originated in his belief that the Japanese buyer paid a lot for Westbeach Homeless Skateboards and the brand name’s appeal was because of the “L” in the name (Kowitt & Leahey, 2013; Leahey, 2013).

Growing up, Chip Wilson’s family struggled with money and his parents divorced when he was 12. He felt he must rely on himself for survival. This background influenced his need to control every situation which created problems in his management of lululemon. Chip later attended a leadership-development course taught by Landmark which was pivotal in his career as a manager and leader. The course helped him realize his professional and personal weaknesses and that he needed outside assistance to run the company. It was so inspirational that newly hired employees were required to set one-, five-, and ten- year personal, professional and health goals during their orientation. After being with the company for one year, employees were offered an opportunity to attend a three-day Landmark seminar and it was quickly deemed as imperative, not optional, for employees (Kowitt & Leahey, 2013).

Company highlights include (Marketline Company Profile, 2013 & 2016; 2018 10-K report):

- 2004: lululemon opened its first store in Australia
- 2005: Entered into a partnership with Descente to establish the ‘lululemon Japan’ joint venture
- 2007: Listed on the NASDAQ Stock Exchange using the trading symbol “LULU”
- 2009: Opened the first showroom in Hong Kong
- 2011: Launched ivivva -- athletica’s girls line
- 2012: Entered into an agreement to resolve pending design patent litigation on yoga pant designs with Calvin Klein
- 2013: Entered into a partnership with Nobel Biomaterials to use the company’s X-STATIC antimicrobial technology in its apparel lines. X-STATIC provides permanent odor protection by naturally stopping the growth of bacteria on the surface of fabrics
- 2014: Opened the first standalone men’s store in Soho, New York
- 2015: Opened the first stores in the UK and Singapore and the first showroom in China
- 2018 saw an upheaval in senior leadership. Laurent Potdevin resigned February 2, 2018 and Patrick Guido replaced Haselden as CFO on April 16, 2018.

COMPANY OPERATIONS

Products

Athletic apparel is sold under the lululemon and ivivva brand names. Products include women’s, men’s, and girl’s outerwear, sweaters, tops, tanks, sports bras, pants, crops, shorts, skirts, and yoga bottoms along with accessories such as headwear, underwear, yoga mats, water bottles, and bags (2018 10-K report). In 2017 the company added new fabric, Evenlux, and a new Enlite bra. Although part of the

women's clothing industry, lululemon focuses on athletic wear for women (with additional product lines for men and young females) and charges a premium price (\$98 for yoga pants) for products. The company strives to set itself apart from competitors through product design, fabric innovations, and through its healthy lifestyle values.

Market

The company's target market is sophisticated and educated women who know the importance of a healthy lifestyle. The company believes these women exercise in the pursuit of achieving physical fitness and inner peace. Although products are primarily for women, the company has also designed products for men and girls.

lululemon sells products at company-owned stores, directly to the consumer via the internet and its websites, and other outlets that include wholesale accounts (yoga studios, health clubs and fitness centers), outlets (used to sell slow moving inventory), showrooms (small locations opened when entering a new market to feature a limited number of products), and temporary locations. As of January 28, 2018, the company has a total of 404 company operated stores. There are 270 lululemon stores in the U.S., 57 in Canada, and 28 in Australia. Other store locations are in the United Kingdom, New Zealand, China, Hong Kong, Singapore, South Korea, Germany, Puerto Rico, and Switzerland. There are four ivivva stores in the U.S. and three in Canada. The company expects to open additional stores in the US and Asia in 2018. Internet sales account for 21.8% of total revenues and sales from other outlets account for 8% of revenue (2018 10-K).

Licensing and supply agreements are used to partner with specific companies and/or individuals who have had success in a target market. In January 2015, lululemon entered into a five-year licensing and supply agreement with a Middle Eastern partner who will operate retail locations in the United Arab Emirates, Kuwait, Qatar, Oman and Bahrain. As of January 29, 2017, the partner had opened three licensed stores in the United Arab Emirates and one in Qatar. lululemon entered into a ten-year licensing and supply agreement with a partner in November 2016 to open retail stores in Mexico. As of January 28, 2018, no locations were in operation in Mexico (2018 10-K).

The company relies on local ambassadors, digital marketing, social media, in-store community boards, and grassroots initiatives to market its products.

Product Design, Manufacturing and Distribution

The product design team is comprised of athletes and users of the lululemon products who work with international designers along with input from ambassadors and guests to develop products that reflect the company's design philosophy and dedication to quality. The team incorporates technically advanced and innovative fabrics to bring the most advanced apparel to customers.

lululemon does not own any manufacturing facilities and relies on a limited number of suppliers to provide fabrics and manufacturers to make products. The company relies on long-standing relationships with vendors but does not rely on long-term contracts. Vendors are selected with great care and must go through a screening process to ensure that they meet company values and meet the Vendor Code of Ethics regarding legal, human and ethical standards of production while caring for the environment. Partners' facilities are assessed by in-house experts and third parties during announced and unannounced inspections. lululemon has a zero-tolerance policy for lack of transparency, forced labor, unapproved subcontractors, minimum wage violations, child labor, corruption, human trafficking, and bribery (lululemon website: responsible supply chain, 2018).

Sixty-five suppliers provide fabrics and 47 suppliers manufacture the company's products. In FYE 2016, five manufacturers produced 64% of the products and no single manufacturer provided more than 25% of the company's products. Approximately 53% of the products were produced in South East Asia, 28% in South Asia, 10% in China, and 8% in North America (2018 10-K).

Products at lululemon are developed using a number of technologies and fabrics. Waterproof technology is used to develop waterproof fabric that resists water from penetrating the cloth and going inside. Waterproof technology tapes and seals seem to keep water from going inside the product. The

company's Luon fabric withstands stretch and sweat. Evonatural fabrics (Tech Terry, Tech Pima, Qwick Oxford and Qwick Chino) are soft and comfortable. Naturally breathable fabrics (Boolux, Cotton Fleece, Pima cotton, Stretch French Terry, Tencel and Vitasea) are made with natural fibers to provide extra softness. Mesh fabric and Coolmax fabric are lightweight, stretchy and absorb sweat (MarketLine 2016).

In 2017 the company developed new fabric, Everlux, for its women's lines especially for high impact, high intensity indoor workouts, and a new Enlite bra (2018 10-K).

Retail stores and other outlets are supplied products from five distribution centers located in the US, Canada and Australia. Third party providers in Hong Kong, China, and the Netherlands are used to warehouse and distribute products (2018 10-K).

Employees

lululemon has 13,400 employees as of January 28, 2018, with 7,400 working in the U.S., 3,500 in Canada, and 1,700 outside of North America. New employees are 'indoctrinated' during a boot camp that lasts 60 days. During that time, employees learn about corporate structure and a culture in which managers must trust their direct reports' ability to achieve success (2018 10-K; Brown, 2016).

Financial Report

TABLE 1
FISCAL YEAR ENDED

	January 2 2018	January 29, 2017	January 31, 2016
	<i>(In thousands)</i>		
Net revenue	\$2,649,181	\$2,344,392	2,060,523
Cost of goods sold	1,250,391	1,144,775	1,063,357
Gross profit	1,398,790	1,199,617	997,166
Selling, general and administrative expenses	904,264	778,465	628,090
Income from operations	456,001	421,152	369,076
Other income (expense), net	3,997	1,577	(581)
Income before income tax expense	459,998	422,729	368,495
Income tax expense	201,336	119,348	102,448
Net income	<u>\$ 258,662</u>	<u>\$ 303,381</u>	<u>\$ 266,047</u>

Source: 2018 10-K

In fiscal year ending January 28, 2018, the company saw a 14% increase in net revenue, a 17% increase in gross profit and a 7% increase in comparable store sales. However, while gross profit increased, net profit declined to below 2016 fiscal year earnings.

The company saw the following as last fiscal year's successes (2018 10-K report):

1. The opening on new stores and new store formats.
2. Product innovations
3. Enhanced e-commerce offerings.
4. Increase brand recognition with better brand initiatives.
5. Development of a new fabric, Everlux, for women's high intensity indoor workouts with new bras that offer "guests" proprietary technology for running and high impact training.

6. Relaunch of their websites.
7. A grassroots approach to brand building- lead by stores and store associates who they refer to as educators who connect with their “guests,” determine their needs, and help develop innovative products and marketing.

The company sees the following as major goals going forward (2018 10-K):

1. While keeping their focus on their largest customer group, women, they have developed a comprehensive men’s line with a strategy targeting men.
2. The digital strategy focuses on pursuing the channel agnostic model, improving the website and mobile experience, and leveraging the guest database.
3. At the time of the 2018 10-K report they had 404 stores in 12 countries, which they see as a venue to serve their clients and as a direct connection to their consumers.
4. The company expects fiscal year 2018 revenue to increase between \$2.9 billion and \$3.01 billion (lululemon website, 2018).

Sustainability & Social Responsibility

lululemon embraces social, environmental, and economic health not only within the organization, but also in the global communities in which the company operates. In 2011 the company completed a thorough carbon and energy assessment to understand its footprint and find ways to make changes to decrease its footprint. This resulted in a new distribution center in Ohio to take advantage of ground transportation when providing goods to stores. The company continues to complete a carbon and energy assessment every year (lululemon website 2017 and website 2018). The company works with its manufacturers for sustainable manufacturing and supports the UK anti trafficking and human slavery in manufacturing and supply chains (lululemon website, 2018).

Recycling is big at lululemon, and the distribution centers have achieved an 86% recycling rate. One way this is achieved is to re-use boxes. Employees are encouraged to use recycling bins in the workplace and the company is working to reduce packaging waste by working with municipalities to ensure plastic recycling is available. lululemon partners with DEBRAND which ensures that 98% of damaged products are recycled into material called ‘shoddy’ which can be used as mattress stuffing and for insulation in homes, cars and athletic equipment such as boxing gloves and punching bags (lululemon website, 2018).

Partnerships with non-profits around the globe highlights the ‘Here to Be’ program that supports the work of the yoga service community. The Africa Yoga Project (AYP) was created by Paige Elenson and lululemon ambassador Baron Baptiste and has been supported by lululemon through grants, along with yoga mat and product donations. In 2016, a \$50,000 grant from lululemon supported curriculum development at the AYP Academy which provides life and job skills to yoga teacher training graduates. Kevin Pierce, a lululemon ambassador, suffered a traumatic brain injury in 2009 that ended his snowboarding career. He and his brother, Adam, founded ‘LoveYourBrain’ which is a nonprofit organization dedicated to helping those with TBI through community programs that improve the quality of life (lululemon website, 2018).

THE ATHLETIC APPAREL & WOMEN’S CLOTHING STORE INDUSTRY

The athletic apparel and women’s retail clothing industry is highly competitive and fragmented which typically results in price competition and reduced profit margins. The women’s clothing retail store industry had a -1.3% growth rate between 2012 and 2017 and is predicted to see -0.4% growth between 2018 and 2022 with a possible decline of 10% in 2018 alone (IBIS World, 2017). However, industry growth is expected to be generated by premium brands and specialty stores, such as premium denim, athletic apparel, and ecoclothing stores. There are 36,484 stores in the U.S. and total revenue for the industry is \$41.8 billion. It is also predicted that there will be more consolidation of national brands in the next five years (Hurley, 2017).

lululemon’s main competitors include companies that sell athletic apparel such as Nike, Inc., Adidas AG, and Under Armour Inc. Other competitors include companies that also carry an athletic apparel line

such as The Gap (Athleta brand), Lucy Activewear (V.F. Corporation), bebe stores, and L Brands, Inc. (Victoria Sport at Victoria's Secret). lululemon is susceptible to new entry by major companies that decide to add an athletic line to their clothing stores. In addition, Target and Wal-Mart sell a limited line of athletic apparel (both sell yoga pants) at low prices creating price wars. Many of lululemon's competitors are large corporations, with substantial resources, who promote their brands through print media, television commercials and celebrity endorsements (2018 10-K; Marketline 2016; 2018 10-K report).

There are a number of key external drivers in this industry. As per capita disposable income increases, as it is expected to in the next few years, consumers will have more money to spend on discretionary items such as clothes. The number of households earning more than \$100,000 per year is expected to rise which means consumers in the higher income brackets are more likely to shop at specialty stores and be more willing to pay higher prices for items. As income inequality rises, discount stores and online stores will have greater opportunities to offer discount prices, non-luxury brands, and 'generic' brands to consumers. Female adults between the ages of 20 and 39 are the key purchasers of women's clothing. The number of adults aged 20 to 64 is expected to increase in the future (Hurley, 2017). IBIS World (2017) notes that e-retailers aggressively pursued lower priced items up to 2018 and are expected to be a major competitor for the higher priced brands such as lululemon from 2018 forward.

Many key success factors are important to companies competing in the women's clothing store industry. These include (Hurley, 2017):

- Attractive product presentation and a store layout that improves the shopping experience.
- Established brand that encourages customer attention and shopping.
- Efficient and effective inventory control to increase turnover and decrease excess inventory.
- Quality staff that provides superior customer service.
- Locations where there is high traffic volume.
- Products which are consistent with current fashion trends.

LULULEMON IN 2017 and 2018

After a successful 2016 year, lululemon started 2017 on a down note with a slow start. When CEO Laurent Potdevin announced that fiscal 2017 revenue would be between \$2.55 billion and \$2.66 billion, shares lost about 21% in value. The company earned \$2.64 billion in 2017 (Gensler, 2017; Kell, 2017; 2018 10-K report). During the last ten years, lululemon's stock price reached a high of \$77.81 per share on May 1, 2013 and in April 2018 was trading at \$99.48.

What contributed to this first quarter 'slow start'? Potdevin suggested it was the lack of bold colors on the e-commerce site stating, "We should have been bolder with the color assortment. You are going to see more color showing up and we've added creative resources to bring visual merchandising to life in a more powerful way" (Kell, 2017). Leo Sun (2017) suggests lululemon is relying on product innovations and international expansion (new stores) to boost growth rather than attracting more customers to its existing stores. He questions if the lack of color is the issue or if the slowdown is a result of competition from Nike, Adidas, Gap's Athleta, and even Beyonce's Ivy Park brand. CFO Stuart Haselden noted that the company has experienced weak sales conversions on its website. Sun concludes this may be a problem since lululemon relaunched its website a year ago and if the company cannot align the website to customer preferences this may affect its mobile application.

Analysts note changing trends in the women's apparel industry. The 'athleisure' trend is losing luster. Nike, Under Armour, and lululemon all benefited from the fashion trend of fitness clothing being worn for everyday wear. The industry is seeing consumers making fewer visits to brick-and-mortar stores and spending more money online (Kell, 2017). The industry is also beginning to experience saturation and commoditization of products (Sun, 2017).

Recognizing that millennials are a major part of the company's customer base, lululemon has partnered with a creative agency to launch a global advertising campaign with content especially for

millennials (Mau, 2017). Will an appeal to millennials be enough to attract new customers to lululemon's products? Have there been too many product issues in the past five years for the company to continue to keep its core customers? How should lululemon and the executive team prepare for the changing environment, social trends, and competitive landscape?

Can lululemon continue its rebound with the headwinds from a very competitive industry, changing buying habits, mistrust from past mistakes, and sudden changes in senior leadership?

TEACHING NOTE

lululemon athletica, Inc. was founded in 1998 by Chip Wilson with a focus on comfortable, innovative athletic wear for women dedicated to a healthy, fit lifestyle. The company has since then expanded to include a men's line and a girl's line (ivivva brand).

lululemon has been plagued with several product and image issues. In 2006, the Vitasea line was marketed as being made with seaweed when in fact it was made of a cotton fabric. Colors in some products bled when washed. In 2008, a bag with inspirational quotes was sold, but when washed less than inspirational notes appeared. It was discovered in 2010 that reusable shopping bags contained lead and the product had to be pulled from shelves. The fiasco of the see-through black yoga pants occurred in 2013, which resulted in the pants being pulled from store shelves and refunds being offered to customers. The US Consumer Product Safety commission found dangerous elastic tips in elastic drawstrings of certain jackets and hooded tops in 2015, which resulted in a recall and products pulled from shelves.

In addition to product issues, the company has had management issues. Chip Wilson made disparaging remarks about women when the transparent yoga pant issue came to light. His comments angered many women and the company lost some loyal customers. After the company went public in 2007, a new CEO was hired. Christine Day attempted to re-align the company with Wilson's original vision, but Chip Wilson's 'control freak' mentality and his actions and interference caused confusion among employees and created tension with Day and other managers. When Laurent Potdevin was hired in 2014, the Board sent Wilson into exile forcing him to relinquish shares and not be involved in management. Potdevin has been working to restore the company and he hired a CFO to oversee the supply chain, product quality and develop an internal infrastructure to help the company run more smoothly. However, Potdevin abruptly resigned in February 2, 2018 and the CFO, Haseldon, was replaced on April 16, 2018 by Patrick Guido.

By 2018, lululemon operated 404 company operated stores in 12 countries and earned 19.3% of its revenues from its internet sites. The company works with 65 suppliers who provide fabric and 35 suppliers who manufacture the product. The company relies on a 'grassroots' marketing program to promote the brands.

The competitive landscape is changing in the retail women's apparel and women's athletic apparel industry. Companies such as Nike, Adidas AG, Under Armour, and The Gap (Athleta brand) sell specialty women's athletic apparel and Target and Wal-Mart have added a limited selection of low-price yoga pants and athletic wear to their product lines. Consumers are shopping more online and brick-and-mortar stores are seeing less traffic. The industry is predicted to have negative growth in the next five years, is very competitive, and is considered a saturated market.

Suggestions for Using the Case

This case is appropriate for marketing or management courses. Marketing topics include building a brand, brand management, and brand reputation. Management topics include analysis of the macro and competitive environments, leadership and what happens when the company out-grows the founder, ensuring appropriate operations, and identifying actions a company can take when the market becomes highly competitive and saturated with slow growth.

Learning Objectives

1. Analyze company actions by applying Brand Management principles.
2. Analyze the macro-environmental forces.
3. Analyze the competitive environment using Porter's Five Forces Analysis.
4. Evaluate the leadership and actions taken.
5. Make recommendations for future courses of action.

Suggested Assignment Questions

1. How might a company build a brand in a niche market?
2. What is brand/reputation management and how might that be applied to lululemon?
3. What actions should lululemon take to grow/maintain its brand in a changing retail market?
4. Prepare an analysis of macro-environmental factors and discuss how they impact the industry and lululemon using a SWOTS analysis
5. Prepare a Porter's Five Forces analysis of the industry.
6. What are some issues typically encountered with the Founder when a company outgrows its simple corporate structure? Evaluate the actions taken by Chip Wilson and the Board of Directors to replace Wilson, Potdevin, and Haseldon.
7. What are appropriate actions a company might take in a slow growing, saturated, highly competitive environment?
8. What recommendations would you make to the new CRO and a new CEO?

Answers to Question 1. How Might a Company Build a Brand in a Niche Market?

Niche branding plays a large role in the success of almost any small or large business, both offline or online. A brand is one of the most important (yet intangible) assets that any company can possess. Without a brand, buyers and audiences will usually ignore your business and your offer in favor of better-known brands, which they believe will deliver proven, reliable results (Keller, 2013).

Niche branding, also called narrow branding, is connecting with your audience (customers and prospects) in a targeted way that focuses on their needs and circumstances. Niche branding embraces the positive qualities of the brand, sharing them in more detail with select customers. Therefore, in niche branding, it will be about how the market, prospects, and customers view and perceive the brand.

Today's consumers are savvier, more informed, and better connected than ever before. They share information, express their opinions, and influence one another's decisions in ways that traditional mass media cannot comprehend or market to effectively. In order to succeed, brands must be adaptable and constructed around the lives of consumers. They cannot present themselves in a single, unswerving way anymore. They need to focus on individual target audiences, whose needs and desires drive the promises, the individual elements, and even the visual language behind the brand.

Niche branding starts with segmentation of the market, breaking down consumers by groups that share common lifestyles and interests. Then, it completely re-imagines every aspect of the brand—the brand experience, product mix, usability, distribution, content, and media—as though the entire brand was originally conceived and built for each consumer segment (Keller, 2013).

While planning your niche brand, you must keep in mind some important things about your business. These are (Scanlon, 2011):

- Who is your target client, prospect, or customer?
- How will you be introduced to or approach these people?
- What are their biggest burdens and the problems they face?
- How do you intend to affect these and/or how can you solve their problems?
- What makes your offer better than your competitor's?

It is also very important to build a personal relationship with your customers. By doing this your target market will be more open to you about their wants and needs, which can be a tremendous help for you in building your niche brand.

The main purpose of niche brand building is creating a lasting impression on your target market. Building a brand while focusing on your niche does take some time. However, given effort and focus, it will develop you as a name in your niche (Scanlon, 2011).

Answers to Question 2. What is Brand/Reputation Management and How Might that Be Applied to lululemon?

Strategic brand management includes the design and implementation of marketing programs and activities to build, measure, and manage brand equity. The customer-based brand equity framework recognizes the importance of the customer in the creation and management of brand equity (Keller, 2013). Consumers own brands, and your brand is what consumers will permit you to have. Consistent with this view, customer-based brand equity is defined as the differential effect that consumers' brand knowledge has on their response to the marketing of that brand. A brand has positive customer-based brand equity if customers react more favorably to a product and the way it is marketed when the brand is identified, than when the product carries a fictitious name or no name (Keller, 2013).

The basic premise of customer-based brand equity is that the power of a brand lies in the minds and hearts of consumers, and what they have experienced, learned and felt about the brand over time. Therefore, the strength, favorability, and uniqueness of brand associations that consumers have in their minds is very important to the reputation of the brand (Keller, 2013).

This can be applied to lululemon in that they can work on making sure they create positive, strong, and unique associations in consumer's minds with respect to the brand. This can be done through different forms of promotion (advertising, sales promotions, sponsorships, PR, social media, etc.). Making sure consumers are delighted and expectations are met will lead to happy loyal consumers who will continue to purchase the brand over time.

Answers to Question 3. What Actions Should lululemon Take to Grow/Maintain its Brand in a Changing Retail Market?

Lululemon has different strategies it can follow:

1. Niche branding – focusing on a specific segment of consumers with a specific product line (see answer to question 1).
2. Brand extension – creating an extension to one of its brands in order to meet the needs of a new segment of consumers.
3. Line extension – create different kinds of products under a specific brand to meet changing consumer needs.
4. Introduce a new brand – to meet the needs of a new segment of consumers (without diluting the brand image of its existing brand(s)).

Answers to Question 4. Prepare an Analysis of Macro-environmental Factors and Discuss How They Impact the Industry and lululemon Using a SWOT Analysis.

Strengths

- Lululemon's strengths are its upscale clothing line that appeals to sophisticated and educated consumers.
- Loyal customers.
- Multiple locations.
- Broad product line.
- Seen as a unique item --- customers are willing to pay more.
- Socially responsible.
- Use of multiple fabrics.

Weaknesses

- Some customers still remember the past product quality blunders and the degrading comments about women by the former CEO, Chip Wilson. These perceptions will last for some time. Any more negative publicity would severely weaken the company especially if dissatisfied customers go digital with their issues.
- Website is not custom tailored for their target market.
- Their upscale product line targets sophisticated educated women and men.

Opportunities

- Health trends in the US.
- Yoga is a meditation stress-relieving activity that more and more people are engaging in.
- Millennial demographic is large.
- Young adults now working at good paying jobs.

Threats

- The company is highly susceptible to economic cycles. During recessions, the middle class and lower income classes will spend less of their discretionary income on upscale items.
- Average clothing size for women is 14 above their maximum size of 12.
- Growing number of obese individuals in the US.
- Competitive industry with sizeable, nimble, and aggressive competitors. It is difficult to obtain a sustainable competitive advantage because most moves can be quickly imitated.
- Substitute products are available.
- E-retailers aggressively pursued lower cost products up to 2018 and are expected to compete against higher priced products such as lululemons.

Answers to Question 5: Prepare a Porter's Five Forces Analysis of the Industry.

Suppliers

Given their past issues with supplier quality, lululemon has taken several steps to protect themselves. The company uses approximately 65 sources of fabric and 35 manufactures. This limited number allows the company to enforce strict standards. All the suppliers are monitored for quality, child labor, working conditions, and working conditions. Suppliers not adhering to their standards are quickly eliminated. Given this relationship, suppliers have limited power over lululemon.

Customers/Buyers

Their target market is educated and sophisticated males and females who have the discretionary income for upscale products. Consequently, for these groups price is less important than function and perhaps image and they exercise collective buying power only in response to blunders and perhaps economic cycles.

Possibility of New Entrants

Although there are several large competitors creating concentration in this industry, new entrants are always attempting to enter the market. Much of the industry is driven by fads which provide entry windows for new items.

Competitive Rivalry

There are some big companies that are mature, nimble, resource flush, and are willing to fiercely compete each other. Although each company tries to attain some "uniqueness" it is difficult to obtain and hold a sustainable competitive advantage. Most competitors can easily imitate or counter each other.

Possibility of Substitute Products

In considering the entire clothing industry, substitute products would be clothes that are made at home. With lululemon in the athletic apparel industry, there are many casual clothes that may be used for exercising and leisure wear.

Conclusion and Implications

This is a very competitive industry. Customers are fickle and will move quickly to other companies and products to follow fads, respond to economic conditions, and respond to negative social media. Given these issues Lululemon must be better prepared.

Answers to Question 6: What are Some Issues Typically Encountered with the Founder When a Company Outgrows its Simple Corporate Structure? Evaluate the Actions Taken by Chip Wilson and the Board of Directors.

The progression of a company through an idea, a vision, a successful marketed entry, a small company, a growth company, and then a large company entails continual evolution of the company's strategy, structure, and processes. However, this also requires the founder to grow with their successful company. Very few entrepreneurs have "successfully" grown personally with their company. Unfortunately, the skills at one level are not successful at the next growth phase. Chip Wilson's needs for control were successful at the idea, the initiation, and the growth phase but not in the bureaucracy phase. Other examples include the tumultuous experience of Steve Jobs at Apple. Conversely, Howard Head of Head Skis went from a visionary to consultant to the board and knew when to delegate, empower others, and let go of operational decision making.

Chip Wilson did not improve his skill set as the company grew so the Board acted appropriately in reducing his influence. However, the Board has created turmoil in senior leaderships by replacing Potdevin and Haseldon.

Answers to Question 7: What Are Appropriate Actions a Company Might Take in a Slow Growing, Saturated, Highly Competitive Environment?

A company can either divest and get rid of many product lines to focus on one (or two) and start niche branding (see question 1) or expand product lines to target a brand-new segment of the market.

Answers to Question 8: What Recommendations Would You Make to Whoever Replaces Potdevin?

Lululemon has several initiatives that it should continue including: movement to upscale athletic men's wear, use of male "ambassadors", environmental initiatives, recycling, and pursuit of water resistant athletic wear.

Option One

The most important long-term strategy is to develop a reputation management team, acquire customer testimonials, and have satisfied customers ready to defend the brand if an issue occurs. Currently, anyone with a grievance and a computer can instantly create significant social media negatively. Without a prepared plan, most companies stumble initially as Chip Wilson did after his interview which leads the public to question everything else that is stated.

Option Two

The company could continue as they are now by expanding into male athletic wear using male "ambassadors" and increasing in store promotions and social media to communicate these efforts.

Option Three

The company can decide to focus on niche branding (specific segment of the market and specific products) so that it can become an expert in that industry.

Option Four

A long term and more difficult option is to broaden their product line. A unique possibility is to develop a separate brand that provides athletic wear to occasional athletics, those who are overweight, or to lower end consumers. This worked with athletic shoes – when they first appeared they were used only by serious athletics. Then occasional athletes and non-athletes started using them for their comfort and sometimes for the “image.” This strategy should be accomplished with a separate brand to avoid diluting their upscale image. This strategy would somewhat insulate them from economic downturn.

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