

BEYOND THE DIVIDEND:

REI'S FUTURE IN RECREATION

MBA 617
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CASE DESCRIPTION

HISTORY AND OVERVIEW

Recreational Equipment, Inc. (REI) is a major retailer of sports and recreational equipment. REI originally formed as the Recreational Equipment Cooperative (REC) in 1938. It was the brainchild of Lloyd and Mary Anderson who dreamed of bringing their passion for climbing and outdoor recreational equipment to their friends and other enthusiasts. The idea sprang from an inability to find ice axes that would stand up to the rigors of frequent ice-climbing. In their first year of operation, REC had 23 members who each paid \$1 for their lifetime membership. Currently it costs \$20 for a membership at REI. By 1940 REI had grown to 200 members, and by 1950 the cooperative had a membership base of 5,000 people. Finally in 1956, REI members decided to change their business model and incorporate under the name of Recreational Equipment, Inc – a nonprofit. Their success grew rapidly through the 60’s, 70’s, and 80’s; and by 1990 they had 26 retail stores and two million members. They have continued the trend of growth through the new millennium, and in December 2013, REI reported:

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| ▪ \$1,325,937,000 in total assets | ▪ \$868,808,000 in gross profit |
| ▪ \$2,017,476,000 in net sales | ▪ \$19,031,000 in net income |

They expanded to online sales with their first website in 1996, offering free shipping, expert customer service, and an easy return/exchange policy as incentives.

Their headquarters is now located in Kent, WA, with major distribution centers in Bedford, PA and Sumner, WA. REI’s brick and mortar stores span all across the United States in more than 100 locations. Although starting out rather specialized, REI has developed into a recreational generalist. Like many other retail sales giants, REI manufactures and sells their own products as well as products from other vendors. As of February 7th, 2015, REI had 1,002 different vendors (including their own) with products for sale on REI.com. 80% of their revenue comes from brick and mortar stores, but their online free shipping keeps them extremely competitive with other online retail price-points. Major competitors in their industry fall into three categories: online retailers, equipment manufacturers, and brick and mortar retailers. REI’s competitors are listed below, but are not limited to:

- **Online retailers:** Sierra Trading Post, Backcountry.com, Campor, Cabelas, Eastern Mountain Sports, and Amazon.com.
- **Equipment manufacturers:** Patagonia, The North Face, Columbia, and Kelty.
- **Brick and mortar retailers:** Sports Authority, Dick’s Sporting Goods, and many independent stores.

As stated earlier, REI is a generalist, and as such does not cater to the highly advanced specialized product crowd. They do carry products which are considered more advanced and higher quality, but smaller companies with niche markets are typically not represented in the REI store lineups. REI wants to sell you products from the first day you started a new sport, and carry you through until you’re an expert. You’ll still find things you need at REI once expert status is achieved, but you will find yourself looking elsewhere to find specialized items that are only found at independent stores. REI has also branched out into guided outdoor trips, classes, and clinics to round out their comprehensive approach to recreational equipment sales.

REI’s claims strength from its employees. REI has been on Fortune Magazine’s “100 Best Companies to Work For” list (in the US) every year since 1998, and placed as number seven in the top 10 retailers to work for in Glassdoor’s 2013 Retail Report. Their focus is to employ people who have a passion for the outdoors, like to have fun and feel like a family at work, and to give back to the community that they represent. Business sustainability is another prominent theme for REI. They emphasize sustainable business operations as the cornerstone of their production strategy. Their stewardship policy is touted on their website, and outlines six categories they want to constantly improve upon, and is detailed in **Table 1, REI Sustainable Operations**.

Table 1, REI Sustainable Operations

Category	Aspiration
Greenhouse Gas Emissions	Become climate-neutral in operations by 2020
Energy	Grow business while managing total energy use.
Waste	Become a zero waste-to-landfill organization by 2020
Paper	Align use of paper with values through strategic sourcing
Green Building Techniques	Create buildings that reflect REI’s values and minimize environmental impact
Product Sustainability	Know, disclose, and address product impacts

Overall, REI is a fun-loving organization that wants its employees and its customers to embrace sustainability, learn new outdoor activities, and grow beyond their comfort zone.

ORGANIZATIONAL CHANGES

REI's business model has been fairly consistent throughout their lifespan. They aren't planning any major changes in the near future, but must continue to do what they have done well in the past. One area that they are putting a lot of resources into is their Outdoor Education and Adventures programming. We may see some changes to how they structure their programs here, involving a more comprehensive local theme or perhaps more direct product marketing as the environment gets more competitive.

OBSTACLES AND ISSUES

REI has few problems within their organization. They are a poster child for success, but do need to find new ways of upholding the core values that set them apart from competitors. The one problem they have is not really a problem within their organization, but an issue that arises from their environmental stewardship goals. As manufacturing, distribution, and shipping costs increase, REI must struggle to stay competitive while also staying a leader in operational sustainability and accountability. Sustainable business practices can be more expensive than conventional methods. And as such, REI needs to continue to innovate and find creative ways to not only be a leading environmental steward, but also keep prices in target ranges to stay ahead of competition.

Another problem that has been reported through an interview from sales staff is a relatively high turnover rate. This is also apparently coupled with an uneducated, in terms of recreational equipment, replacement workforce (P. Karr, personal communication, February 21, 2015). If more than a local problem, these issues will have significant repercussions to the type of environment REI aims to set for customers.

ORGANIZATIONAL FUTURE

REI should continue to have a strong future in the recreational equipment industry. While looking at historical data available back to 2004, we see that total active members and gross sales have risen consistently every year since 2004. But interestingly, net income has gone up and down throughout the years. As seen in **Figure 1, Historical Net Income**, profits dropped sharply in 2008 along with the recession. However, they rose past 2004 levels the following year, and stabilized around \$30,000,000 for the next two years before dropping again in 2012. Profits won out in 2013, gaining amounts not seen since 2005. Looking strictly at financial figures we can conclude that REI is susceptible to market fluctuations and economic pressure. They should however continue to profit as long as they stay

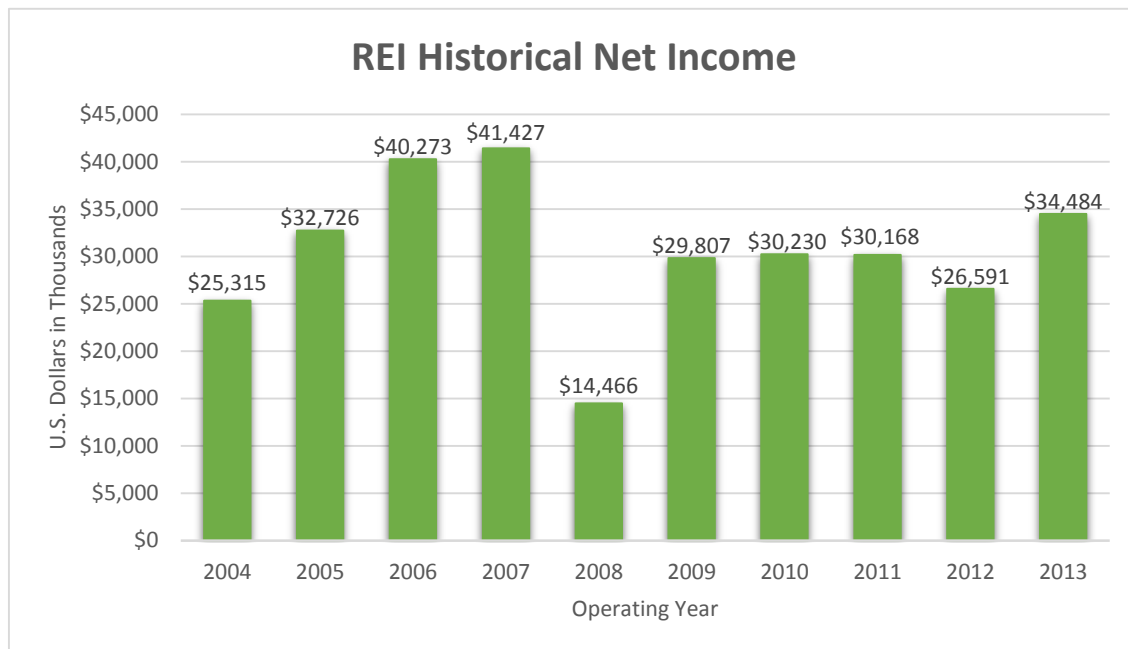


Figure 1, Historical Net Income

competitive with other recreational equipment retailers, even in the face of poor US economic performance. Strategies for competitiveness will be discussed in the following sections.

CASE ANALYSIS

This case analysis will examine the goal of maintaining operational sustainability, in relation to environmental stewardship, while also staying profitable and identifying new revenue streams. Their focus of environmental stewardship is woven into their organizational culture, and sets them apart from the rest of the industry. This approach cannot be abandoned without becoming an entirely different

company. High standards for operational sustainability come with a price tag, and will become more cost prohibitive as global resources dwindle from industrial over-extraction. In order to counteract the additional cost of remaining environmentally conscious, REI will need to capture more market share and find new ways to generate revenue. Otherwise competitors with less sustainably-oriented agendas will undercut REI's prices and cater to the majority of customers who just want lower prices. Solutions to this issue will be discussed in the following sections.

RECOMMENDATIONS ON CHANGE

Generating new revenue streams will be difficult as more and more companies encroach on REI's market share through small-business entrepreneurship. Small companies have less overhead to manage, are more versatile and flexible with innovation, and are able to respond to niche customer needs quicker than large corporations. All of these aspects create obstacles for REI's future. Top management executives must recognize the need to move forward with new strategies for increased market share. Below are three strategies for increasing revenue and market share, with brief explanations of the overall concept:

1. ENGAGE WITH GOVERNMENT ENTITIES TO CREATE JOINT VENTURE RECREATIONAL AREAS.

REI's current branding focuses on environmental stewardship and sustainability. Their goal is to give back to communities in ways that protect and natural environment and enhance recreational opportunities for everyone. This can be done in a way that not only upholds their corporate culture and responsibility goals, but also has a direct positive effect on revenue streams. Government-funded departments that manage public recreational areas and lands generally are underfunded and have many "shelved" projects. REI could create joint ventures with Government entities that give them part-ownership in recreational land management. In this structure, Government departments such as the Bureau of Land Management would manage the administrative operational staffing, as well as the general maintenance of the area. REI would then manage the programming, marketing, gear rentals and sales, and lead infrastructure improvement projects in coordination with the Government. In this way, REI and the Government both

outsource tasks that the other specialize in. REI would be able to carve out exclusive advertising terrain while also renting, selling, and promoting their own gear. The Government benefits by generating revenue on their previously undeveloped land while undertaking responsibilities already in their expertise.

2. REQUIRE GEAR RENTAL AND SALES RIGHTS AS A CONDITION OF GRANT DISTRIBUTION.

REI currently distributes hundreds of grants from their nonprofit corporation, The REI Foundation. On its website REI claims, “This year REI awarded \$4.2 million in grants to more than 300 nonprofit organizations for preservation and restoration projects in 650 locations.” REI could require that every project have conditions that allow them exclusive rights to advertise, rent, and sell their products if applicable to the nature of the project. For example, if the non-profit organization was restoring scenic trails in forested mountain area, REI could provide trail-marking signage that also has their name on it. Rental shops or small “pro-shops” could be put up in conjunction with regular supervisory stations if there was a need to provide supervisory staffing in the area. This way people would get more use out of the land by having gear readily available to them that they might not otherwise purchase or rent.

3. REINVENT THE REI PRODUCT BRAND TO MARKET HIGH-TECH SUSTAINABILITY INSTEAD OF VALUE.

REI manufactures its own products and markets them to the value-conscious outdoor explorer. Although this is a substantial market in its own right, the value-minded branding doesn't align with REI's organizational culture. REI puts sustainability and stewardship before value, and as such should market its own products with the same spin. This will differentiate its products from the rest of the industry, and align those products with the core company culture. REI is already bringing in ecologically savvy customers through its extensive environmental stewardship campaign, sustainable products will only strengthen the culture that is currently in place.

MANAGERIAL APPLICATIONS

In order for solutions to be implemented correctly, there needs to be a clear plan for managers to follow and lead their team with. The following discussion will go through implementation strategies at

the middle-management level to show how the three solutions mentioned in the previous section will be applied on a practical level.

GOVERNMENT-PRIVATE INDUSTRY JOINT VENTURES.

In order for businesses to thrive, relationships must be sought and nurtured. Organizational relationships are the key to creating new recreational space for users to frequent. A collaboration between REI and the Government to create a joint venture enterprise would allow each organization to utilize their strengths in the manner that each performs best.

Regional managers would use their local expertise to research and target under-utilized areas of land to capitalize on. Evaluation criteria would be developed to focus potential opportunities and give managers a comprehensive view of what each project has to offer, along with the resources that would be necessary to fully develop the area. Once a target area has been chosen by a regional manager, they would reach out to the pertinent Government entity that holds title to the land and is responsible for its oversight. A “champion” would be chosen by the Government to act as the project manager for their side, and the REI regional manager would act as the project manager for the REI side. Together, they would build a team of experts to develop the project consisting of local contractors, available and pertinent volunteer organizations, and subject matter experts from the recreational industries that would be represented in the project. Once estimates and designs for the project are completed, REI would handle any necessary financing that would need to occur from commercial lending sources. The Government would handle the necessary permitting and regulatory activities required to get the project off the ground. After funding and permitting is in place, construction could begin through proper bid solicitation processes and final acquisition of contractors. Upon completion of the project, the Government and REI would settle into their operational roles. REI will handle the day-to-day management of the gear sales and rentals, guiding and tours, events, and promotion of the area. The Government will perform maintenance services, administrative duties, and regulatory oversight to keep the area within environmental compliance. Through this interorganizational relationship, every party involved benefits: the Government gets revenue

through use of underdeveloped land, REI receives revenue through sales and promotion, and users get another opportunity to recreate in their own backyard.

GRANT DISTRIBUTION CONDITIONS.

REI's annual grant contributions to non-profit organizations are currently without stipulations that allow REI to insert themselves into the project they are funding. The REI Foundation evaluates proposals with specific criteria that discerns whether the project aligns with the goals and organizational culture present at REI. To maximize these opportunities, evaluators for the REI Foundation would write counter-proposals that include the previous project proposal, but add in conditions for exclusive rights for REI to promote their brand and establish "pro-shops" for gear sales and rentals. REI evaluators would consult with top managers from departments such as Retail, Human Resources, Information Technology, Marketing, Finance, and Outdoor Programs to identify an approach that is beneficial to REI. The amended proposal would then go up to the board of Corporate Officers for final REI approval. If approved by the Corporate Officers, the amended proposal would be submitted back to the original requesting agency for their approval. Once approved on both sides, REI and the partnering organization would meet to discuss responsibilities of each party. An operational agreement would also be drafted for lines of responsibility, demarcation of duties and authority, and other pertinent operational procedures. The project would then move forward in the manner that has been outlined in the amended proposal.

RE-BRANDING REI-MANUFACTURED PRODUCTS.

To re-brand REI's self-manufactured products as high-tech and sustainable, a different approach to product development would need to be taken. Innovation and creativity would need to be nurtured in a more structured environment. REI could establish a strategy of corporate entrepreneurship to leverage their in-house expertise for new product development. Using the Enabler model of corporate entrepreneurship, every employee would be given unlimited opportunities to develop a new product idea. Employees would be allowed to submit proposals for new products to the Chief Creative Officer. The Chief Creative Officer would then select employees that submitted the most promising ideas to spend time in an official re-assignment to the Product Development department. The newly transferred

innovator would act as the idea champion for that project, and collaborate with the staff that work full time in the Product Development department to assess the idea's feasibility. Prototypes would be developed, along with projections on cost, sales, and profit. These projections and prototypes would be given in a formal presentation to the board of Corporate Officers. The purpose of the presentation would be to determine interest in an Officer to volunteer as the new idea's sponsor. If an Officer agreed to be the sponsor of the idea, the new product would move to the next phase of development. This final phase would roll the new idea into REI's normal product development processes to get the new idea to market. After completion of the project, the employee who was the original innovator would return to their old position. They would also given a bonus commensurate with the scale of revenue projected for their new idea. Notes would be put in their human resources file that identify them as potential promotable staff. If a job came up within REI that the employee wished to apply for, the idea's success and the employee's performance during the development phase would be considered as a major factor in their evaluation for the new position.

IMPLICATIONS OF MANAGERIAL APPLICATION.

It is the author's opinion that the approaches described in the previous sections are feasible with the right organizational support. All of them will require change strategies that have full management approval and backing through the entire implementation process. As a manager for REI, it would be possible to use any of the proposed solutions to the company's advantage. However, none of the solutions could be implemented without a global change throughout the company. In this respect, the proposed solutions may not be considered immediately feasible. They should however, be considered as immediately feasible *to be proposed*. As a manager, it would be first necessary to write the complete proposed change in a comprehensive change plan that fully documented the scope of the change, the processes involved in the operation of the proposed change, the funding required for the change, and a projected profit-realization and recovery over the next five years if the change was implemented. A team would be assembled from different departments within REI that acted as subject matter experts for the proposal. They would provide insight and content development for the change. Once the proposal for

change was completed, it would be presented to a select Corporate Officer or select group of Officers for initial approval and to gain top-management sponsorship. Then if support was received, a full presentation would be given to the entire board of Officers. If approved at that level, strict deadlines would be set initiating a one-year development phase, a one-year testing and refinement phase, and a final two-year implementation project that deployed the entire solution.

REI is a thriving company, and has few organizational issues that hinder its performance. With careful consideration and planning, they will be a recreational powerhouse for years to come. New interorganizational relationships and change strategies will bolster their success in the future, securing outdoor recreation opportunities for people around the world.

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APPENDIX A: ORGANIZATIONAL CHART

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