

lululemon athletica, Inc.

CASE 6

connect

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In early 2012, investor interest in lululemon athletica—a designer and retailer of high-end, yoga-inspired athletic apparel under the lululemon athletica and ivivva athletica brand names—was surging. Over the past 30 months, growing numbers of female shoppers were patronizing the company's stores to pay premium prices for lululemon-branded items that offered performance, fit, and comfort and were stylish as well. The company's functional and stylish apparel had taken on "must have" status among growing numbers of fitness-conscious women. People were flocking to lululemon stores not only because of the fashionable products but also because of the store ambience and attentive, knowledgeable store personnel. The company had responded by opening additional stores—35 in 2010 and 40 in 2011—and embellishing its product offerings to create a comprehensive line of apparel and accessories designed for athletic pursuits such as yoga, running, and general fitness; technical clothing for active female youths; and athletic products for men.

As lululemon's sales revenues climbed rapidly toward \$1 billion annually, the company's stock price had risen from \$2.25 per share on March 9, 2009 to close at \$64.58 per share on February 3, 2012. Business analysts were speculating how long the lululemon athletica phenomenon would last and whether the company could carve out a sustainable market position for itself in the fitness and athletic apparel industry against such competing names as Nike, Under Armour, adidas, and Reebok.

In 2012, the company's products could be bought at its 174 retail stores in the United States, Canada, Australia, and New Zealand, and at the company's website, www.lululemon.com. For the fiscal year ending January 29, 2012, lululemon reported net revenues of

\$1.0 billion and net earnings of \$184.1 million. Retail store sales accounted for 81.7 percent of company revenues, website sales accounted for 10.6 percent, and other (including wholesale sales to franchised stores, showroom sales, and sales at outlet centers) accounted for 7.7 percent.

COMPANY BACKGROUND

A year after selling his eight-store surf-, skate-, and snowboard-apparel chain called Westbeach Sports, Chip Wilson took the first commercial yoga class offered in Vancouver, British Columbia, and found the result exhilarating. But he found the cotton clothing used for sweaty, stretchy power yoga completely inappropriate. Wilson's passion was technical athletic fabrics and in 1998 he opened a design studio for yoga clothing that also served as a yoga studio at night to help pay the rent. He began offering upscale yoga clothing made of performance fabrics and asked local yoga instructors to wear the products and give him feedback. Gratified by the positive response to yoga apparel, Wilson opened lululemon's first real store in the beach area of Vancouver, called Kitsilano, in November of 2000.

While the store featured Wilson-designed yoga clothing, Chip Wilson's vision was for the store to be a community hub where people could learn and discuss the physical aspects of healthy living—from yoga and diet to running and cycling, plus the yoga-related mental aspects of living a powerful life of possibilities. But the store's clothing selections proved so popular that dealing with customers crowded out the community-based discussions and training about the

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merits of living healthy lifestyles. Nonetheless, Chip Wilson and store personnel were firmly committed to healthy, active lifestyles, and Wilson soon came to the conclusion that for the store to provide staff members with the salaries and opportunities to experience fulfilling lives, the one-store company needed to expand into a multistore enterprise. Wilson believed that the increasing number of women participating in sports, and specifically yoga, provided ample room for expansion, and he saw lululemon athletica's yoga-inspired performance apparel as a way to address a void in the women's athletic apparel market. Wilson also saw the company's mission as one of providing people with the components to live a longer, healthier, and more fun life.

Several new stores were opened in the Vancouver area, with operations conducted through a Canadian operating company, initially named Lululemon Athletica, Inc. and later renamed lululemon canada inc. In 2002, the company expanded into the United States and formed a sibling operating company, Lululemon Athletica USA Inc. (later renamed as lululemon usa, inc), to conduct its U.S. operations. Both operating companies were wholly owned by affiliates of Chip Wilson. In 2004, the company opened a franchised store in Australia as a means of more quickly disseminating the lululemon athletica brand name, conserving on capital expenditures for store expansion, and boosting revenues and profits. The company wound up its fiscal year ending January 31, 2005 with 14 company-owned stores, 1 franchised store, and net revenues of \$40.7 million. A second franchised store was opened in Japan later in 2005. Franchisees paid lululemon a one-time franchise fee and an ongoing royalty based on a specified percentage of net revenues; lululemon supplied franchised stores with garments at a discount to the suggested retail price.

Five years after opening the first retail store, it was apparent that lululemon apparel was fast becoming something of a cult phenomenon and a status symbol among yoga fans in areas where lululemon stores had opened. Avid yoga exercisers were not hesitating to purchase \$120 color-coordinated lululemon yoga outfits that felt comfortable and made them look good. Mall developers and mall operators knew what lululemon was and had begun actively recruiting lululemon to locate stores in their malls.

In December 2005, with 27 company-owned stores, 2 franchised stores, and record sales en route to \$85 million annually, Chip Wilson sold 48 percent of his interest in the company's capital stock to a group

of private equity investors led by Advent International Corporation, which purchased 38.1 percent of the stock, and Highland Capital Partners, which purchased a 9.6 percent ownership interest. In connection with the transaction, the owners formed lululemon athletica inc. to serve as a holding company for a number of the company's related entities, including the two operating subsidiaries, lululemon canada inc. and lululemon usa inc. Robert Meers, who had 15 years of experience at Reebok and was Reebok's CEO from 1996–1999, joined lululemon as CEO in December 2005. Chip Wilson headed the company's design team and played a central role in developing the company strategy and nurturing the company's distinctive corporate culture; he was also chairman of the company's board of directors, a position he had held since founding the company in 1998. Wilson and Meers assembled a management team with a mix of retail design, operations, product sourcing, and marketing experience from such leading apparel and retail companies as Abercrombie & Fitch, Limited Brands, Nike, and Reebok.

Brisk expansion ensued. The company ended fiscal 2006 with 41 company-owned stores, 10 franchised stores, net revenues of \$149 million, and net income of \$7.7 million.

In 2007, the company's owners elected to take the company public. The initial public offering took place on August 2, 2007, with the company selling 2,290,909 shares to the public and various stockholders selling 15,909,091 shares of their personal holdings. Shares began trading on the NASDAQ under the symbol LULU and on the Toronto Exchange under the symbol LLL.

The company's announced growth strategy had five key elements:

- 1. Grow the company's store base in North America.** The strategic objective was to add new stores to strengthen the company's presence in locations where it had existing stores and then selectively enter new geographic markets in the United States and Canada. Management believed that the company's strong sales in U.S. stores demonstrated the portability of the lululemon brand and retail concept. Plans were to open 20 to 25 stores in fiscal 2007 and 30 to 35 stores in fiscal 2008 in the United States and Canada.
- 2. Increase brand awareness.** This initiative entailed leveraging the publicity surrounding the opening of new stores with grassroots marketing programs

that included organizing events and partnering with local fitness practitioners.

3. **Introduce new product technologies.** Management intended to continue to focus on developing and offering products that incorporated technology-enhanced fabrics and performance features that differentiated lululemon apparel and helped broaden the company's customer base.

4. **Broaden the appeal of lululemon products.** This initiative entailed (1) adding a number of apparel items for men, (2) expanding product offerings for women and young females in such categories as athletic bags, undergarments, outerwear, and sandals, and (3) adding products suitable for additional sports and athletic activities.

5. **Expand beyond North America.** In the near term, the company planned to expand its presence in Australia and Japan and then, over time, pursue opportunities in other Asian and European markets that offered similar, attractive demographics.

The company's growth and success over the next five years were impressive by any standard. Exhibit 1 summarizes the company's recent performance. In March 2012, top management projected that lululemon's full-year fiscal 2012 net revenues would be in the range of \$1.3 billion to \$1.325 billion and that diluted earnings per share would be in the range of \$1.50 to \$1.57. In early May 2012, lululemon's stock traded in the \$75 to \$80 price range, up from \$15 per share at the beginning of 2010.

In January 2008, Christine M. Day joined the company as executive vice president, retail operations. Previously, she had worked at Starbucks, functioning in a variety of capacities and positions, including president, Asia Pacific Group (July 2004–February 2007), co-president for Starbucks Coffee International (July 2003 to October 2003), senior vice president, North American Finance & Administration; and vice president of sales and operations for Business Alliances. In April 2008, Day was appointed as lululemon's president and chief operating officer, and was named chief executive officer and member of the board of directors in July 2008. She held those positions in early 2012. During her tenure as CEO, Day had expanded and strengthened the company's management team to support its expanding operating activities and geographic scope, favoring the addition of people with relevant backgrounds and experiences at such companies as Nike, Abercrombie & Fitch, The Gap, and Speedo International. She also spent a number of hours each week in the company's stores observing how customers shopped, listening to their comments and complaints, and using the information to tweak product offerings, merchandising, and store operations.

Company founder Chip Wilson stepped down from his executive position as lululemon's chief innovation and branding officer effective January 29, 2012, but continued in his role of chairman of the company's board of directors.

EXHIBIT 1 Financial and Operating Highlights, lululemon athletica, Fiscal Years 2007–2012 (in millions of \$)

	Fiscal Year Ending Jan. 29, 2012	Fiscal Year Ending Jan. 30, 2011	Fiscal Year Ending Jan. 31, 2010	Fiscal Year Ending Feb. 1, 2009	Fiscal Year Ending Jan. 31, 2007
Selected Income Statement Data					
Net revenues	\$1,000.8	\$711.7	\$452.9	\$353.5	\$148.0
Cost of goods sold	431.6	316.8	229.8	174.4	72.2
Gross profit	569.3	394.9	223.1	179.1	75.7
Selling, general, and administrative expenses	282.3	212.8	136.2	118.1	51.9
Operating profit	287.0	180.4	86.5	56.6	16.6
Net profit (loss)	185.0	121.8	58.3	39.4	7.7
Earnings per share					
Basic	\$1.29	\$0.86	\$0.41	\$0.29	\$0.06
Diluted	1.27	0.85	0.41	0.28	0.06

(Continued)

EXHIBIT 1 (Concluded)

	Fiscal Year Ending Jan. 29, 2012	Fiscal Year Ending Jan. 30, 2011	Fiscal Year Ending Jan. 31, 2010	Fiscal Year Ending Feb. 1, 2009	Fiscal Year Ending Jan. 31, 2007
Balance Sheet Data					
Cash and cash equivalents	\$409.4	\$316.3	\$159.6	\$56.8	\$15.5
Inventories	104.1	57.5	44.1		26.6
Total assets	734.6	499.3	307.3	211.6	71.3
Stockholders' equity	606.2	394.3	233.1	154.8	37.4
Cash Flow and Other Data					
Net cash provided by operating activities	\$203.6	\$180.0	\$118.0	\$45.4	25.4
Capital expenditures	116.9	30.4	15.5	40.5	13.3
Store Data					
Number of corporate-owned stores open at end of period	174	133	110	103	41
Number of franchised stores open at end of period	0	4	14	10	10
Sales per gross square foot at corporate-owned stores open at least one full year	\$2,004	\$1,726	\$1,318	\$1,450	\$1,411
Average sales at corporate- owned stores open at least one year	\$5.33 million	\$4.96 million	\$3.76 million	\$4.06 million	\$4.93 million

Source: Company 10-K reports for fiscal years ending, January 31, 2008, February 1, 2009, January 30, 2011, and January 31, 2012.

LULULEMON'S STRATEGY AND BUSINESS IN 2012

In 2012, lululemon athletica continued to view its core mission as "providing people with the components to live a longer, healthier and more fun life." Its primary target market was:

"a sophisticated and educated woman who understands the importance of an active, healthy lifestyle. She is increasingly tasked with the dual responsibilities of career and family and is constantly challenged to balance her work, life, and health. We believe she pursues exercise to achieve physical fitness and inner peace."

Management believed that other athletic apparel companies were not effectively addressing the unique style, fit, and performance needs of women who were embracing yoga and a variety of other fitness and athletic activities. lululemon sought to address this void in the marketplace by incorporating style, feel-good comfort, and functionality into its apparel products and using its retail store network to market directly to these women. Almost 16 million Americans, of

which nearly 73 percent were women, spent an estimated \$5.7 billion on yoga classes and products in 2011.¹ However, while the company was founded to address the unique needs and preferences of women, management recognized the merits of broadening the company's market target to include other population segments. Recently, it had begun designing and marketing products for men and athletic female youths who appreciated the technical rigor and premium quality of athletic and fitness apparel. Management also believed that participation in athletic and fitness activities was destined to climb as people over 60 years of age became increasingly focused on living longer, healthier, active lives in their retirement years and engaged in regular exercise and recreational activities. Another demand-enhancing factor was that consumer decisions to purchase athletic, fitness, and recreational apparel were being driven not only by an actual need for functional products but also by a desire to create a particular lifestyle perception through the apparel they wore. Consequently, senior executives were positioning the company to capitalize on the broadening market potential for lululemon apparel that loomed ahead.

The chief components of the business strategy that top management had launched when lululemon athletica became a public company in mid-2007 remained largely intact in 2012:

- Grow the store base in North America, primarily the United States.
- Open additional stores outside of North America.
- Increase awareness of the lululemon brand and apparel line.
- Incorporate next-generation fabrics and technologies in the company's products to strengthen consumer association of the lululemon brand with technically advanced apparel products and enable lululemon to command higher prices for its apparel products compared to the prices of traditional athletic apparel.
- Broaden the product line by designing lululemon products for a bigger range of athletic activities.
- Provide a distinctive in-store shopping experience, complemented with strong ties to fitness instructors and fitness establishments, local athletes and fitness-conscious people, and various community-based athletic and fitness events.

Perhaps the two biggest strategic adjustments since 2007 had been to discontinue and reverse the use of franchising as a component of the company's retailing and store expansion strategy and to launch a direct-to-consumer strategic initiative whose principal thrust was selling apparel at the company's website, www.lululemon.com.

Retail Distribution and Store Expansion Strategy

After several years of experience in establishing and working with franchised stores in the United States, Australia, Japan, and Canada, top management in 2010 determined that having franchised stores was not in the company's best long-term strategic interests. A strategic initiative was begun to either acquire the current stores of franchisees and operate them as company stores or convert the franchised stores to a joint venture arrangement where lululemon owned the controlling interest in the store and the former franchisee owned a minority interest. In some cases, contracts with franchisees contained a clause allowing lululemon to acquire a franchised store at a specified percentage of trailing 12-month sales. The three franchised stores in Canada became company-owned in

2009 and 2010. The franchise rights of nine store locations in Australia, in which lululemon already had an ownership interest, were acquired during 2010; five of nine franchised stores in the United States were converted to company-owned in 2010 and 2011. The franchised store established in Japan in 2005 was converted to a company-owned store months after it opened. The last four franchised stores—three in Colorado and one in California—were reacquired in 2011.

As of February 2012, lululemon's retail footprint included:

- 47 stores in Canada scattered across seven provinces, but mainly located in British Columbia, Alberta, and Ontario.
- 108 company-owned stores in the United States (27 states and the District of Columbia).
- 18 stores in Australia.
- 1 store in New Zealand (opened in 2011).

Virtually all stores were branded lululemon athletica, but five company-owned stores were branded ivivva athletica and specialized in dance-inspired apparel for female youths.

Current store expansion efforts were concentrated mainly in the United States. The company's plans for 2012 called for opening 30 new stores in the U.S., 2 ivivva athletica-branded stores in Canada, and 5 new stores in Australia and New Zealand. Over time, management expected to expand into additional countries, primarily Asia and Europe, either by opening company-owned stores or by entering into joint ventures with experienced and capable retail partners.

Lululemon management undertook ongoing evaluations of the company's portfolio of company-owned store locations. Underperforming store locations were closed. One California store was closed in 2009. In 2010, one corporate-owned ivivva athletica store in British Columbia and one corporate-owned lululemon athletica store in Australia were closed. No stores were closed in 2011.

In fiscal year 2011 ending January 31, 2012, the company's retail stores that had been open at least one year had average sales of \$2,004 per square foot, versus average sales per square foot of \$1,726 in fiscal 2010 and \$1,318 in fiscal 2009 (Exhibit 1). Management believed its sales-per-square-foot performance had consistently been the best in the retail apparel sector—for example, the stores of specialty fashion retailers like J Crew and Abercrombie & Fitch typically had annual sales averaging \$600–\$700 per square foot.

Lululemon's Store Showroom Strategy

In 2012 lululemon had "showrooms" in 35 locations in the United States, 4 Australian locations, 2 New Zealand locations, and 1 location in Hong Kong. Showrooms functioned as a means of introducing the lululemon brand and culture to a community, developing relationships with fitness instructors and fitness enthusiasts, and hosting community-related fitness events, all in preparation for the likely opening of a new lululemon athletica retail store in the near future. Showroom personnel worked with local athletes, recruited fitness instructors to be ambassadors for lululemon products and lululemon-sponsored fitness events, hosted get-acquainted parties for fitness instructors and fitness enthusiasts, and acted as local experts on where to find great yoga or Pilates classes, fitness centers, and health and wellness information and events. Showrooms were only open part of the week so that personnel could be out in the community meeting people, participating in local yoga and fitness classes, and promoting attendance at various fitness activities and wellness events. In addition, showroom personnel began the process of recruiting well-regarded local yoga studios, health clubs, and fitness centers to stock and retail a selection of lululemon's products.

Wholesale Sales Strategy

Lululemon marketed its products to select yoga studios, health clubs, and fitness centers as a way to gain the implicit endorsement of local fitness instructors and personnel for lululemon branded apparel, familiarize the customers of these establishments with the lululemon brand, and give them an opportunity to conveniently purchase lululemon apparel. There was no intent to grow wholesale sales to these types of establishments into a significant revenue contributor. Rather, the strategic objective was to build brand awareness, especially in new geographic locales.

Website Sales Strategy

In 2009, lululemon launched its e-commerce website to enable customers to make online purchases and supplement its already-functioning phone sales activities. Management saw online sales as having three strategic benefits: (1) providing added convenience for core customers, (2) making lululemon products in geographic markets where there were no lululemon stores, and (3) helping build brand awareness,

especially in new markets, including those outside of North America. The company's direct-to-consumer channel (online and phone sales) quickly became an increasingly substantial part of the company's business, accounting for revenues of \$57.3 million in fiscal 2010 (8.1 percent of net revenue) and \$106.3 million in fiscal 2011 (10.6 percent of net revenue). lululemon provided free shipping on all orders.

In addition to making purchases, website visitors could browse information about what yoga was, what the various types of yoga were, and their benefits; learn about fabrics and technologies used in lululemon's products; read recent posts on lululemon's yoga blog; and stay abreast of lululemon activities in their communities.

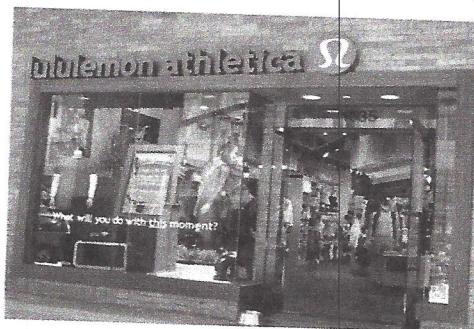
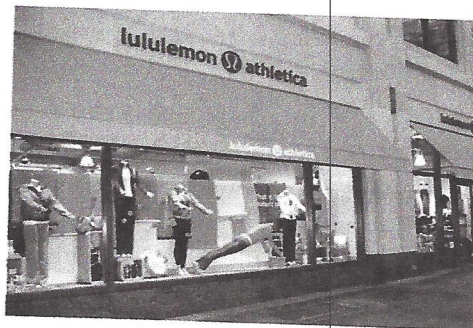
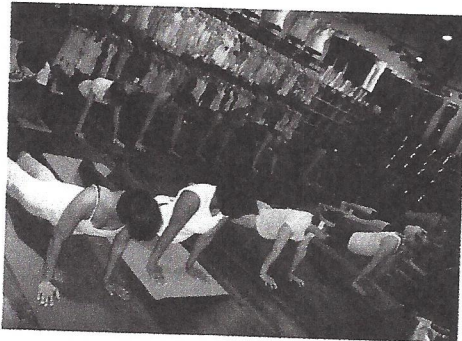
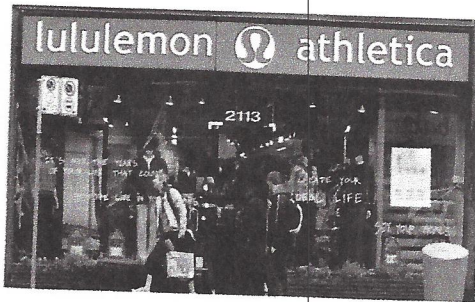
Retail Stores

The company's retail stores were located primarily on street locations, in upscale strip shopping centers, in lifestyle centers, and in malls. Typically, stores were leased and were 2,500 to 3,000 square feet in size. Most all stores included space for product display and merchandising, checkout, fitting rooms, a restroom, and an office/storage area. While the leased nature of the store spaces meant that each store had its own customized layout and arrangement of fixtures and displays, each store was carefully decorated and laid out in a manner that projected the ambience and feel of a homespun local apparel boutique rather than the more impersonal, cookie-cutter atmosphere of many apparel chain stores.

One unique feature of lululemon's retail stores was that the floor space allocated to merchandising displays and customer shopping could be sufficiently cleared to enable the store to hold an in-store yoga class before or after regular shopping hours. Every store hosted a complimentary yoga class each week, complete with yoga mats and a professional yoga instructor; when the class concluded, the attendees were given a 15 percent-off coupon to use in shopping for products in the store. From time to time, yoga ambassadors demonstrated their moves in the store windows and on the sales floor. Exhibit 2 shows the exteriors and interiors of representative lululemon athletica stores.

The company's goal was to sell all of its products at full price.² Special colors and seasonal items were in stores for only a limited time—such products were on 3, 6, or 12-week life cycles so that frequent shoppers could always find something new. Store inventories of short-cycle products were deliberately limited to help

EXHIBIT 2 Representative Exterior and Interior Scenes at lululemon Stores



to create a sense of scarcity, condition customers to buy when they saw an item rather than wait, and avoid any need to discount unsold items. In one instance, a hot-pink color that launched in December was supposed to have a two-month shelf life, but supplies sold out in

the first week. However, supplies of core products that did not change much from season to season were more ample to minimize the risk of lost sales due to items being out-of-stock. Approximately 95 percent of the merchandise in lululemon stores was sold at full price.³

Women		Men
• Sports bras • Tanks • Tops • Jackets • Hoodies • Pants • Crops • Shorts	• Skirts and dresses • Socks and underwear • Gear bags • Caps and headbands • Sweat cuffs and gloves • Water bottles • Yoga mats and props • Instructional yoga DVDs	• Tops • Jackets and hoodies • Shorts • Pants • Gear bags • Socks and underwear • Caps and gloves • Yoga mats, props, and instructional DVDs

Product Line

In 2012, lululemon offered a diverse and growing selection of premium-priced performance apparel and accessories (see the table above) for women, men, and female youths that were designed for healthy lifestyle activities such as yoga, running, and general fitness. While many of its products were specifically intended for the growing number of people that participated in yoga, the company had for some years been broadening its product range to address the needs of other activities.

Exhibit 3 shows a sampling of lululemon's garment offerings.

Product Design and Development

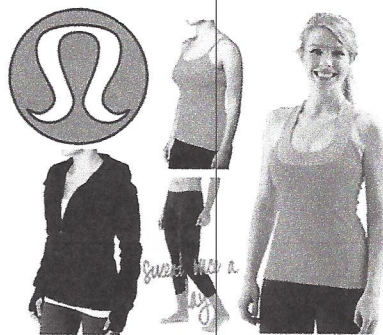
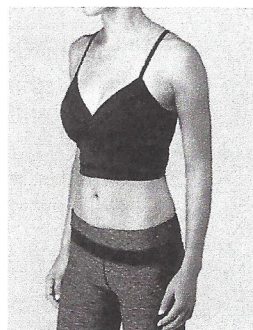
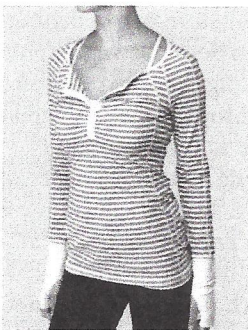
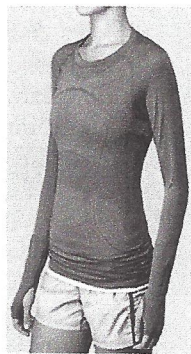
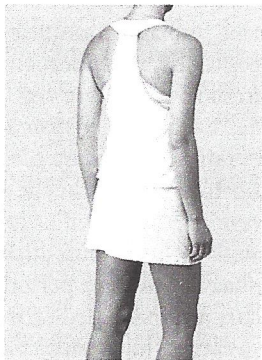
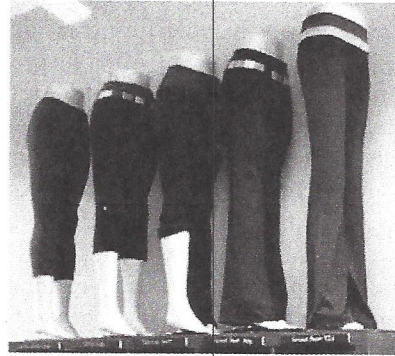
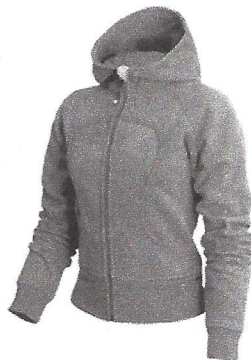
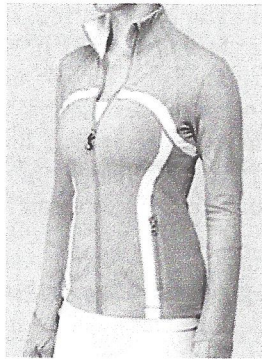
Lululemon's product design efforts were led by a team of designers based in Vancouver and headed by the company's founder, Chip Wilson. The team collaborated closely with various international designers. The lululemon design team included athletes and users of the company's products who embraced lululemon's design philosophy and dedication to premium quality. Input was also actively sought from the fitness ambassadors recruited by store personnel and store customers—ambassadors had become an integral part of the product design process, testing and evaluating products and providing real-time feedback on performance and functionality. Design team members regularly worked at stores to interact with and receive direct feedback from customers. In addition, the design team used various market intelligence sources to identify and track market trends. Plus, the team hosted meetings each year in several geographic markets to discuss the company's products with local athletes, trainers, yogis, and members of the fitness industry and gather their ideas for product improvements and new products. The design team incorporated all of this input to make fabric selections,

develop new products, and make adjustments in the fit, style, and function of existing products.

The design team worked closely with its apparel manufacturers to incorporate innovative fabrics that gave lululemon garments such characteristics as stretch ability, moisture-wicking capability, color fastness, feel-good comfort, and durability. Fabric quality was evaluated via actual wear tests and by a leading testing facility. Before bringing out new products with new fabrics, lululemon used the services of a leading independent inspection, verification, testing, and certification company to conduct a battery of tests on fabrics for such performance characteristics as pilling, shrinkage, abrasion resistance, and colorfastness. Lastly, lululemon design personnel worked with leading fabric suppliers to identify opportunities to develop fabrics that lululemon could trademark and thereby gain added brand recognition and brand differentiation. Trademarked fabrics currently incorporated in lululemon products included:

- *Luon*—a fabric that was designed to wick away moisture, move with the body, and eliminate irritation (was included in more than half of the company's products).
- *Luxtreme*—a wicking fabric that was silky and lightweight and primarily used in running products.
- *Silverescent*—a fabric that reduced odors as a result of the antibacterial properties of the silver in the fabric.

Where appropriate, product designs incorporated convenience features, such as pockets to hold credit cards, keys, digital audio players, and clips for heart rate monitors, and long sleeves that covered the hands for cold-weather exercising. Product specifications called for the use of advanced sewing techniques, such as flat seaming, that increased comfort and functionality, reduced chafing and skin irritation, and strengthened important seams. All of these design elements

EXHIBIT 3 Examples of lululemon Apparel Items

Source: www.lululemon.com, accessed February 13, 2012.

and fabric technologies were factors in enabling lululemon to price its high-quality technical athletic apparel at prices above those of traditional athletic apparel.

Typically, it took 8 to 10 months for lululemon products to move from the design stage to availability in its retail stores; however, the company had the capability to bring select new products to market in as little as two months. Management believed its lead

times were shorter than those of most apparel brands due to the company's streamlined design and development process, the real-time input received from customers and ambassadors at its store locations, and the short times it took to receive and approve samples from manufacturing suppliers. Short lead times facilitated quick responses to emerging trends or shifting market conditions.

Sourcing and Manufacturing

Production was the only value chain activity that lululemon did not perform internally. lululemon did not own or operate any manufacturing facilities to produce fabrics or make garments. All of its products were sourced from a group of 45 manufacturers, five of which produced approximately 67 percent of the company's products in fiscal 2011. However, the company deliberately refrained from entering into long-term contracts with any of its manufacturing suppliers, preferring instead to transact business on an order-by-order basis and rely on the close working relationships it had developed with its suppliers over the years. The fabrics used in lululemon products were sourced by the manufacturers from a limited number of pre-approved suppliers. During the fiscal year ending January 31, 2012, approximately 49 percent of lululemon's apparel products were produced in China, approximately 41 percent in South/South East Asia, approximately 3 percent in Canada, and the remainder in the United States, Israel, Peru, Egypt, and other countries.

Lululemon took great care to ensure that its manufacturing suppliers shared lululemon's commitment to quality and ethical business conduct. All manufacturers were required to adhere to a code of conduct regarding quality of manufacturing, working conditions, environmental responsibility, fair wage practices, and compliance with child labor laws, among others. lululemon utilized the services of a leading inspection and verification firm to closely monitor each supplier's compliance with applicable law, lululemon's workplace code of conduct, and other business practices that could reflect badly on lululemon's choice of suppliers.

The company's North American manufacturers were the reason lululemon had the capability to speed select products to market and respond quickly to changing trends and unexpectedly high buyer demand for certain products. While management expected to utilize manufacturers outside of North America to supply the bulk of its apparel requirement in the years to come, it intended to maintain production in Canada and the United States whenever possible.

Distribution Facilities

Lululemon shipped products to its stores in North America from a leased 102,000-square-foot facility in Vancouver, British Columbia, and a leased 82,000-square-foot facility in Sumner, Washington.

Both were modern and cost-efficient. In 2011, the company began operations at a leased 54,000-square-foot distribution center in Melbourne, Australia, to supply its stores in Australia and New Zealand. Management believed these three facilities would be sufficient to accommodate its expected store growth and expanded product offerings over the next several years. Merchandise was typically shipped to retail stores through third-party delivery services multiple times per week, providing them with a steady flow of new inventory.

Community-Based Marketing

One of lululemon's differentiating characteristics was its community-based approach to building brand awareness and customer loyalty. Local fitness practitioners chosen to be ambassadors introduced their fitness class attendees to the lululemon brand, thereby leading to interest in the brand, store visits, and word-of-mouth marketing. Each yoga-instructor ambassador was also called upon to conduct a complimentary yoga class every four to six weeks at the local lululemon store they were affiliated with. In return for helping drive business to lululemon stores and conducting classes, ambassadors were periodically given bags of free products, and billboard-size portraits of each ambassador wearing lululemon products and engaging in physical activity at a local landmark were posted in their local lululemon store, which helped them expand their clientele.

Every lululemon store had a dedicated community coordinator who developed a customized plan for organizing, sponsoring, and participating in athletic, fitness, and philanthropic events in the local area. In addition, each store had a community events bulletin board for posting announcements of upcoming activities, providing fitness education information and brochures, and promoting the local yoga studios and fitness centers of ambassadors. There was also a chalkboard in each store's fitting room area where customers could scribble comments about lululemon products or their yoga class experiences or store personnel; these comments were relayed to lululemon headquarters every two weeks. Customers could use a lululemon micro website to track their progress regarding fitness or progress toward life goals.

lululemon made little use of traditional advertising print or television advertisements, preferring instead to rely on its various grassroots, community-based marketing efforts.

Store Personnel

As part of the company's commitment to providing customers with an inviting and educational store environment, lululemon's store sales associates, who the company referred to as educators, were coached to personally engage and connect with each guest who entered the store. Educators, many of whom had prior experience as a fitness practitioner or were avid runners or yoga enthusiasts, received approximately 30 hours of in-house training within the first three months of their employment. Training was focused on teaching educators about leading a healthy and balanced life, exercising self-responsibility, and setting lifestyle goals, and preparing them to explain the technical features of all lululemon products and to serve as knowledgeable references for customers seeking information on fitness classes, instructors, and events in the community. New hires that lacked knowledge about the intricacies of yoga were given subsidies to attend yoga classes so they could understand the activity and better explain the benefits of lululemon's yoga apparel.

People who shopped at lululemon stores were called "guests," and store personnel were taught how to "educate" guests about lululemon apparel, not sell to them. To provide a personalized, welcoming, and relaxed experience, store educators referred to their guests on a first-name basis in the fitting and changing area, allowed them to use store restrooms, and offered them complimentary fresh-filtered water. Management believed that such a soft-sell, customer-centric environment encouraged product trial, purchases, and repeat visits.

As of January 29, 2012, lululemon had 5,807 employees, of which 4,872 were employed in the company's retail stores, 157 were employed in distribution, 132 were employed in design, merchandise, and production, and the remaining 646 performed selling, general and administrative tasks, and other functions. None of the company's employees were covered by a collective bargaining agreement and there had been no labor-related work stoppages. Management believed its relations with employees were excellent.

Core Values and Culture

Consistent with the company's mission of "providing people with the components to live a longer, healthier and more fun life," lululemon executives sought to

promote and ingrain a set of core values centered on developing the highest-quality products, operating with integrity, leading a healthy balanced life, self-empowerment and self-responsibility, positive inner development, and individual goal-setting. The company sought to provide employees with a supportive and goal-oriented work environment; all employees were encouraged to set goals aimed at reaching their full professional, health, and personal potential. The company offered personal development workshops and goal-coaching to assist employees in achieving their goals. Many lululemon employees had a written set of professional, health, and personal goals. All employees had access to a "learning library" of personal development books that included Steven Covey's *The Seven Habits of Highly Effective People*, Rhonda Byrne's *The Secret*, and Brian Tracy's *The Psychology of Achievement*. To celebrate their first anniversary as a lululemon employee, staff members and store educators were rewarded with company-paid admission to a three-day weekend Landmark Forum seminar, a transformative workshop intended to help people think and act outside existing limits, act responsibly, and put themselves on a path to realizing their potential. lululemon's CEO, who had attended this Landmark Forum seminar, said, "We feel like Landmark is a tool. It has created a culture of accountability."⁴

All of this culture-related training was a direct result of Chip Wilson's long-term efforts to help employees live healthy, active, and fun lives. From the company's earliest days, Chip Wilson had maintained he didn't start lululemon just to sell premium-priced apparel; he believed an integral part of the company's mission was to give employees and customers a proactive assist on their journey to self-esteem, empowerment, and a fulfilling lifestyle. In the "Chip's Musings" section of the company website, Wilson said "The law of attraction"—(that visualizing goals is the key to attaining them, a central tenet of *The Secret*)—"is the fundamental law that lululemon was built on from its 1998 inception."⁵ He went on to say that "Our vision is 'to elevate the world from mediocrity to greatness,' and we are growing so we can train more people and spread the word of *The Secret*—which to us at lululemon is not so secret."⁶ Wilson, who was the chairman of lululemon's board of directors and owned 35 percent of the company's stock in 2012, was the principal architect of the company's culture and core values, and the company's work climate reflected his business and lifestyle philosophy. He had digested much of his

EXHIBIT 4 The lululemon Manifesto**The lululemon Manifesto**

- Drink FRESH water and as much water as you can. Water flushes unwanted toxins from your body and keeps your brain sharp.
- A daily hit of athletic-induced endorphins gives you the power to make better decisions, helps you be at peace with yourself, and offsets stress.
- Do one thing a day that scares you.
- Listen, listen, listen, and then ask strategic questions.
- Write down your short- and long-term GOALS four times a year. Two personal, two business and two health goals for the next 1, 5, and 10 years. Goal setting triggers your subconscious computer.
- Life is full of setbacks. Success is determined by how you handle setbacks.
- Your outlook on life is a direct reflection of how much you like yourself.
- That which matters the most should never give way to that which matters the least.
- Stress is related to 99 percent of all illness.
- Jealousy works the opposite way you want it to.
- The world is changing at such a rapid rate that waiting to implement changes will leave you two steps behind. DO IT NOW, DO IT NOW, DO IT NOW!
- Friends are more important than money.
- Breathe deeply and appreciate the moment. Living in the moment could be the meaning of life.
- Take various vitamins. You never know what small mineral can eliminate the bottleneck to everlasting health.
- Don't trust that an old age pension will be sufficient.
- Visualize your eventual demise. It can have an amazing effect on how you live for the moment.
- The conscious brain can only hold one thought at a time. Choose a positive thought.
- Live near the ocean and inhale the pure salt air that flows over the water. Vancouver will do nicely.
- Observe a plant before and after watering and relate these benefits to your body and brain.
- Practice yoga so you can remain active in physical sports as you age.
- Dance, sing, floss, and travel.
- Children are the orgasm of life. Just like you did not know what an orgasm was before you had one, nature does not let you know how great children are until you have them.
- Successful people replace the words "wish," "should," and "try," with "I will."
- Creativity is maximized when you're living in the moment.
- Nature wants us to be mediocre because we have a greater chance to survive and reproduce. Mediocre is as close to the bottom as it is to the top, and will give you a lousy life.
- lululemon athletica creates components for people to live longer, healthier, and more fun lives. If we can produce products to keep people active and stress-free, we believe the world will become a much better place.
- Do not use cleaning chemicals on your kitchen counters? Someone will inevitably make a sandwich on your counter.
- SWEAT once a day to regenerate your skin.
- Communication is COMPLICATED. We are all raised in a different family with slightly different definitions of every word. An agreement is an agreement only if each party knows the conditions for satisfaction and a time is set for satisfaction to occur.
- What we do to the earth we do to ourselves.
- The pursuit of happiness is the source of all unhappiness.

Source: www.lululemon.com, accessed February 12, 2012.

philosophy about life in general and personal development into a set of statements and prescriptions that he called "the lululemon manifesto" (see Exhibit 4). The manifesto was a core element of lululemon's culture.

Senior executives believed the company's work climate and core values attracted passionate and motivated employees who were driven to succeed, and they viewed the lululemon workforce as a valuable resource

in enabling the company to successfully execute its business strategy, develop brand loyalty, connect with customers, and achieve strong financial performance. Moreover, many customers reacted quite positively to the educational emphasis store personnel placed on health, wellness, and personal development and to what they had seen or heard about lululemon's manifesto, corporate philosophy, and business mission.

COMPETITION

Competition in the athletic apparel industry is principally centered on product quality, performance features, innovation, fit and style, distribution capabilities, brand image and recognition, and price. Rivalry among competing brands is vigorous, involving both established companies who were expanding their production and the marketing of performance products and recent entrants attracted by the growth opportunities.

Lululemon competed with wholesalers and direct sellers of technical athletic apparel, most especially Nike, The adidas Group AG (which marketed athletic and sports apparel under its adidas, Reebok, and Ashworth brands), and Under Armour. Nike had a powerful and well-known global brand name, an extensive and diverse line of athletic and sports apparel, 2011 apparel sales of \$5.5 billion, and 2011 total revenues (footwear, apparel, and equipment) of \$20.9 billion. Nike was the world's largest seller of athletic footwear and athletic apparel, with over 40,000 retail accounts, and over 470 company-owned stores, 19 distribution centers, and selling arrangements with independent distributors and licensees in over 170 countries; its retail account base for sports apparel in the U.S. included a mix of sporting goods stores, athletic specialty stores, department stores, and skate, tennis, and golf shops.

Adidas and Reebok were both global brands that produced worldwide sports apparel revenues of approximately \$7.5 billion in 2011; their product lines consisted of high-tech performance garments for a wide variety of sports and fitness activities, as well as recreational sportswear. The adidas Group sold products in virtually every country of the world. In 2011, its extensive product offerings were marketed through third-party retailers (sporting goods chains, department stores, independent sporting goods retailer buying groups, lifestyle retailing chains, and Internet retailers), 1,355 company-owned and franchised adidas and Reebok "concept" stores, 734 company-owned adidas and Reebok factory outlet stores, 312 other adidas and Reebok stores with varying formats, and

various company websites (including www.adidas.com and www.reebok.com).

Under Armour, an up-and-coming designer and marketer of performance sports apparel, had apparel sales totaling \$1.0 billion in 2011; as of early 2012, Under Armour products were available in 25,000 retail stores worldwide, 18,000 of which were in Canada and the United States. Under Armour also sold its products directly to consumers through its own factory outlet and specialty stores, website, and catalogs.

Nike, The adidas Group, and Under Armour all aggressively marketed and promoted their high-performance apparel products and spent heavily to grow consumer awareness of their brands and build brand loyalty. All three sponsored numerous athletic events, provided uniforms and equipment with their logos to collegiate and professional sports teams, and paid millions of dollars annually to numerous high-profile male and female athletes to endorse their products. Like lululemon, they designed their own products but outsourced the production of their garments to contract manufacturers.

Lululemon also competed with specialty department store retailers that carried women's athletic apparel, including:

- **The Gap**—a specialty fashion chain with more than 1,100 stores in North America and a product line that included its Bodyfit collection of performance and lifestyle products.
- **Athleta**—a new 10-store chain and online retailer that specialized in comfortable, fashionable, high-performance women's apparel for workouts, sports, physically active recreational activities, and leisure wear. Athleta was a subsidiary of Gap, Inc. and plans called for more than tripling the number of Athleta store locations in upscale metropolitan shopping areas across the U.S. over the next several years. In 2012, Athleta initiated its first national advertising campaign, "Power to the She," to promote the Athleta brand.
- **Nordstrom**—a nationally-respected retailer that had recently introduced its own Zella line of attire for yoga, other fitness activities, and leisure wear; many of the initial products in the Zella collection were designed by a former member of lululemon's design team. In 2012, Zella-branded items could be purchased online at Nordstrom's website and at some 200 Nordstrom full-line department stores (typically 140,000 to 250,000 square-feet in size) and Nordstrom Rack stores (typically 30,000 to 50,000 square-feet in size) in 28 states.

- **Lucy**—Lucy was a women's activewear brand designed for style, performance, and fit that was intended for yoga, running, training, and other fitness and active recreational activities; the product offerings included tops, bottoms, skirts, dresses, jackets, hoodies, sports bras, socks, caps, headbands, and bags/totes. Lucy-branded performance apparel was sold at 65 company-owned Lucy stores across the United States and at www.lucy.com. Lucy was a wholly owned subsidiary of VF Corp., a designer, marketer, wholesaler, and retailer of 23 brands of apparel and footwear, with 2011 sales of \$9 billion.
- **bebe stores**—a 200+ store and online retailer of women's apparel; the company's BEBE SPORT collection was targeted for a variety of fitness and

sports activities and included sports bras, tops, pants, shorts, jackets, hoodies, and tennis outfits.

The items in the Gap Bodyfit, Athleta, Zella, Lucy, and BEBE SPORT collections were typically priced 10 percent to 25 percent below similar kinds of lululemon products. Gap's Athleta stores also offered free yoga classes, sold direct to consumers at www.athleta.com (with free shipping), and was sponsoring 20 female athletes in 2012 (the group included yoga teachers, a karate instructor, a mountain climber, a skier, runners, and a mountain bike racer). In addition, Athleta had a special social media website, www.athleta.net/chi, that connected women with interests in sports and fitness, nutrition and health, tutorials and training plans, and travel and adventure.

ENDNOTES

¹ "Yoga in America," *Yoga Journal*, January 27, 2012, posted at <http://yogawithgaileee.blogspot.com/2010/01/yoga-in-america-study-by-yoga-journal.html>, and accessed February 12, 2012.

² Dana Mattioli, "Lululemon's Secret Sauce," *The Wall Street Journal*, March 22, 2012, pp. B1–B2.

³ Ibid.

⁴ As quoted in Danielle Sacks, "Lululemon's Cult of Selling," *Fast Company*, April 1, 2009, posted at www.fastcompany.com and accessed on February 12, 2012.

⁵ Ibid.

⁶ Ibid.