

Recreational Equipment Incorporated (REI): A Responsible Retail Cooperative

INTRODUCTION

Recreational Equipment Incorporated (REI) is a national retail cooperative famous for its outdoor apparel and equipment. A cooperative consists of individuals who have joined together to secure the benefits of a larger organization. In the case of REI, the company is organized as a consumer cooperative. Members of the cooperative receive a portion of the organization's profits annually based on a percentage of their eligible purchases. As a result, REI maintains a strong focus on customers, an emphasis that has encouraged the organization to offer superior goods and services in areas such as mountain climbing, camping, and other outdoor activities.

This case will discuss REI's social responsibility initiatives and business framework. We begin by analyzing REI's background and business structure. Next, we examine REI's emphasis on employees, the environment, and the community. We then touch upon REI's advocacy efforts and the REI Foundation. The case concludes by looking at some challenges the company must address.

HISTORY AND BACKGROUND

The concept of REI originated due to a need that could not be met locally. During the 1930s Lloyd Anderson, a member of the Pacific Northwest Mountaineers, was looking for a high-quality ice ax at a reasonable cost. After searching without success, Anderson found what he needed in an Austrian Alpine Gear catalog for \$3.50. His find excited the climbing community around Seattle, prompting Anderson to envision a local business that would carry items for mountain climbers at reasonable prices. In 1938 Lloyd Anderson and his wife Mary, along with 21 fellow climbers, founded an outdoor gear consumer cooperative. At first the cooperative was focused specifically on mountain climbing. In fact, its first full-time employee and eventual CEO was John Whittaker, the first American to successfully climb Mt. Everest. Yet over the years REI grew to include gear for camping and hiking, bicycling, fitness, paddling, and more. Today it is the largest consumer cooperative in the United States.

REI is not a publicly traded company. Anyone can shop at REI, but those who wish to become members of the co-op pay \$20 for a lifetime membership. REI members are eligible to receive a 10 percent annual refund on eligible purchases. The more each member purchases from REI, the bigger the refund. Cooperative members can also receive member discounts on products and classes as

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well as vote for REI's board of directors. Thus far, this business model has appeared to work for REI. It has 5.1 million active members and generated revenues of \$1.8 billion in 2011.

BUSINESS STRUCTURE AND PRODUCTS

REI operates more than 125 retail stores in 32 states. To help customers choose the right product, REI retail locations contain features like bike trails and rock climbing walls that allow customers to test the gear. In addition, to make sure that customers purchase products that meet their needs, REI offers a 100% Satisfaction Guarantee. REI retailers also have Internet kiosks to educate consumers about the brands and products it sells.

Although 80 percent of REI sales come from its retail stores, the company has also invested in online technology, direct sales, and mobile apps. REI developed its own iPhone and Android apps to help consumers in their purchasing decisions. Consumers who have these apps can research REI products, make purchases, and, if they are members, check their dividends. REI decided to embark on this new channel due to the immense popularity of mobile applications. The company wants to offer consumers superior services outside as well as inside the store.

REI also owns successful brands of apparel and equipment that are only available in REI stores. Products developed under the REI brands are designed and tested by REI's quality assurance teams in laboratory settings as well as in the field by REI employees. Several organizations have recognized REI Gear and Apparel for its high quality. For instance, REI's Half Dome 2 Tent won the "2010 Editors' Choice Gold" in *Backpacker* magazine and "2010 Gear of the Year" in *Outside* magazine. REI also makes its own brand of bicycles, "Novara," which includes mountain, touring, recreational, and road bikes.

In addition to its outdoor products, REI also provides services to its customers. A newer program that REI offers in select cities is Outdoor School programs. Customers can attend free or low-cost classes for beginners all the way up to experts in climbing, cycling, hiking and camping, navigation, outdoor fitness, outdoor photography, paddling, snow sports, stewardship, and wilderness medicine. REI's Outdoor Schools provide equipment and professional instruction for those who want to increase their outdoor skills. REI also offers a service called REI Adventures. Customers can choose from a number of different trips that REI Adventures puts together. The trips are ranked by the location, type of physical activity, and fitness level. REI Adventures often employs local guides to enhance the travelers' sightseeing experience.

MANAGEMENT STRUCTURE

Although consumer members essentially own the company, REI has a system of management in place to oversee its day-to-day decisions and risks. REI's board of directors can consist of up to 13 directors. Ten of those 13 board directors must be elected by REI members, and one is the REI President and CEO. The board is legally responsible for generating policy and overseeing the performance of REI. Business risk management, compliance, and corporate governance fall under the realm of the Audit and Finance Committee and the Nominating and Governance Committee. While the former manages business risk and compliance, these risks are more financial in nature. The Nominating and Governance Committee recommends nominees for director positions and oversees corporate governance policies. The two other board committees are the Compensation Committee and the Executive Committee.

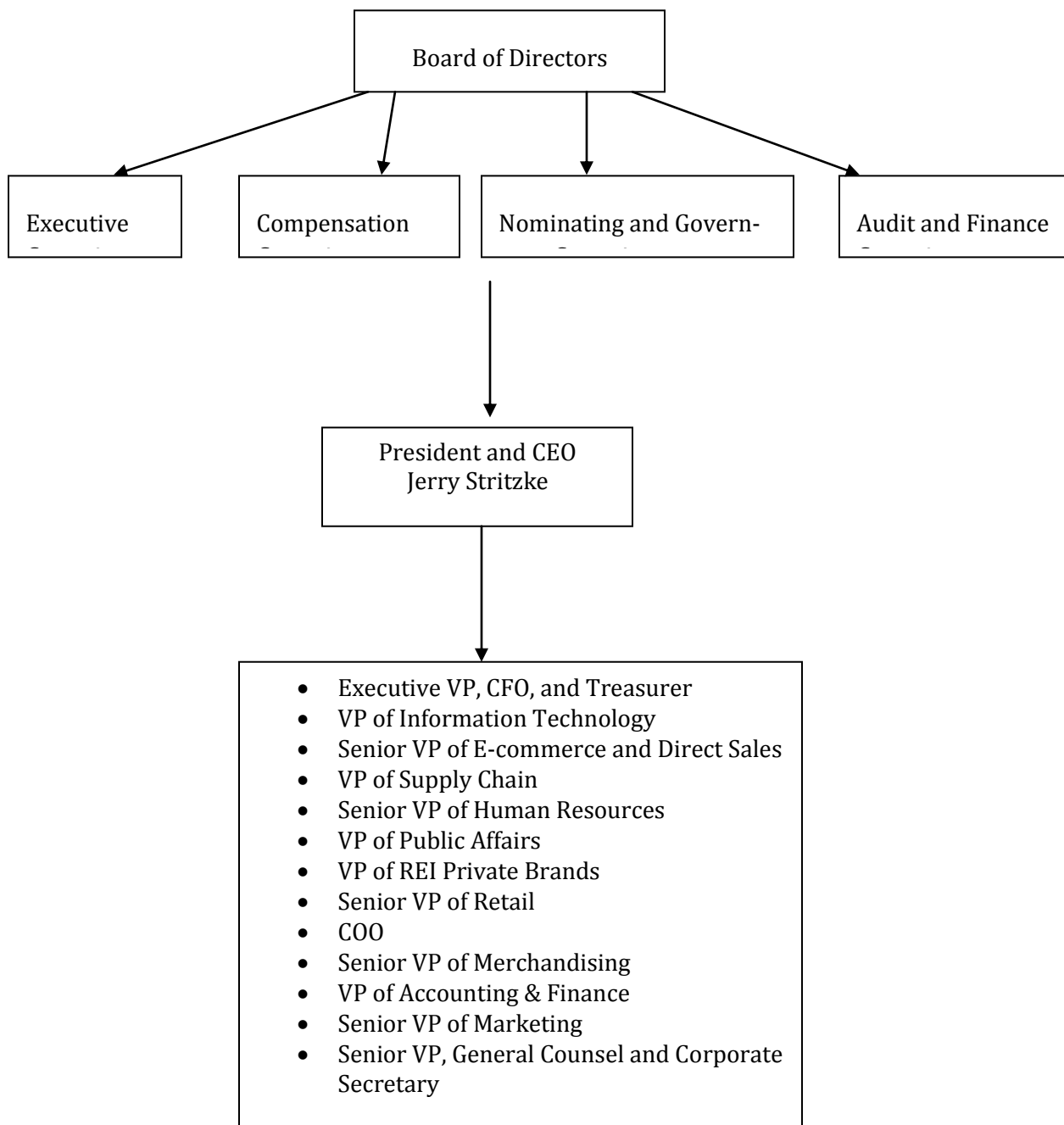
The board encourages REI members to contact them directly. Members are allowed to attend annual meetings to gain a better understanding of company policy and offer feedback. Figure 1 provides a glimpse of how the board and corporate officer positions are organized. As the figure demonstrates, REI has corporate officers specifically for areas such as real estate and customer experience. Current REI CEO Jerry Stritzke replaced former CEO Sally Jewell after she left to become the Secretary of the U.S. Department of the Interior.

Employee relations, consumer safety, supplier relationships, financial status, and community relations all have their own sets of risks. Despite REI's unique business model, a consumer cooperative, the company faces the same risks as any other retailer. For instance, in terms of customer risk, REI stores allow customers to test and experiment with different gear. At the same time, this feature also introduces the risks of potential injury. Managers must be vigilant in mitigating risk through training and protection such as liability insurance. With effective mechanisms in place, REI executives can reduce, if not eliminate, the chance of mishaps.

CORPORATE CULTURE AND VALUES

In its quest to satisfy customers, REI recognizes that its employees are integral to its success as an organization. REI products require a skilled staff that is knowledgeable about outdoor gear. Therefore, REI tries to hire employees who are passionate about the outdoors and who are willing to learn about the products they are selling to consumers. Furthermore, REI prides itself on creating a culture of trust, inclusion, and social responsibility. The company has developed standards for itself and its vendors to ensure that it complies with best industry practices.

Figure 1: Board and Corporate Officer Organizational Structure



Sources: "Corporate Officer," REI, <http://www.rei.com/aboutrei/officers.html>; "Board of Directors," REI, <http://www.rei.com/aboutrei/directors.html> (accessed October 17, 2013).

To demonstrate its commitment to socially responsible practices, REI releases an annual stewardship report. This report highlights not only the organization's social and environmental progress but also major challenges for that year. REI's stewardship report is one way that the organization is able to demonstrate transparency to its stakeholders—a value that the company views as key to being a responsible citizen. REI's annual stewardship report focuses on three stakeholders integral to company success: employees, the environment, and the community. The following sections will describe REI's relationships with these stakeholders in more detail.

EMPLOYEE STAKEHOLDER RELATIONSHIPS

REI recognizes employees as the glue that holds the organization together. With more than 11,000 employees in the United States, REI must manage a complex network of employee relationships, yet it has consistently been recognized as a top employer. The organization has earned a spot on *Fortune* magazine's "100 Best Companies to Work for" every year since 1998. One reason why employees remain loyal to REI is its extensive benefits package. In addition to traditional benefits, REI offers perks that are unique to the company. For instance, employees receive a 50 to 75 percent discount on REI brand products, along with free rentals of certain equipment and a yearly gift of gear. This unique perk makes employees feel valued and familiarizes them with REI products. Other REI benefits include a four-week paid sabbatical after 15 years of employment and a special program called the Challenge Grant, which encourages employees to spend time outdoors. The Challenge Grant awards \$300 in REI gear to employees who participate in challenging outdoor activities. The company contributes to the retirement of eligible employees, with a 5 percent guaranteed contribution and a discretionary 10 percent profit sharing contribution.

REI also offers a Pay for Performance compensation package. This package includes an employee incentive plan called Xcels. Xcels rewards employees and departments for reaching individual, department, and company goals. Although such an incentive plan is a good motivator for employees to strive to meet firm-specific goals, REI must be careful to exert oversight in how these goals are reached. A plan like Xcels could become problematic if employees take ethical short cuts to reach their targets.

REI's employee initiatives and benefits have shown promise. The organization's turnover rate went from 51.5 percent in 2001 to 27.2 percent in 2010. The average employee turnover rate for the retail industry is 51 percent. To ensure that employees are satisfied with REI operations, REI surveys their employees every year. These anonymous surveys measure employee engagement. REI believes that the more employees feel engaged in the firm, the more loyal and satisfied they will be. The survey asks employees questions such as whether the employees support REI values and

whether they would recommend the organization to others. For the majority of the questions, 90 percent or more of respondents viewed the company favorably.

Additionally, REI has made diversity and inclusion an important company value. A diverse workforce has the advantage of reaching a wider array of diverse customers. One way in which REI seeks to increase workforce diversity is by utilizing nontraditional recruiting sources to locate prospective employees from diverse backgrounds. Retail managers and staff are provided with diversity training to help them to create a more inclusive environment for all employees.

Finally, REI recognizes its responsibilities toward the workers in the factories from which it sources. The company has expressed its commitment to go above and beyond local laws in ensuring fair treatment for factory workers. In 1993 REI modeled its factory Code of Conduct after guidelines set forth by the International Labor Organization, a UN agency committed toward establishing fair international labor standards.

Since REI partners with third parties to create the products it sells, the organization has less control over the practices occurring within the factories. It therefore performs visits and social audits to make certain that these manufacturers are complying with REI's factory Code of Conduct. Factory audits are performed by a third party to guarantee the credibility of the audit. The challenge for REI is to balance profitability and long-term supplier relationships with responsible sourcing. REI has therefore partnered with other companies and industry groups to create industry-wide compliance programs and expectations for factories.

As part of this collaboration, REI embarked upon a partnership with the Outdoor Industry Association (OIA) in 2006. Together, the partners created the Fair Labor Toolkit to provide advice for companies and point out ethical issues in labor compliance. REI also joined the Fair Factories Clearinghouse (FFC) in 2009. The FFC is a nonprofit organization dedicated to using software to improve workplaces and business transactions. The partnership between REI and FFC seeks to facilitate collaboration across industries.

ENVIRONMENTAL STAKEHOLDERS

While it may seem unusual to regard the environment as a critical stakeholder, the impact that businesses have upon the natural environment is becoming increasingly important. Climate change, waste management, and pollution concerns affect how businesses conduct their operations. By including the environment as an important stakeholder in its stewardship report, REI acknowledges

the importance of sustainability in its daily activities. Its strategic focus on environmental responsibility has enabled REI to reduce its environmental footprint.

REI has benchmarked four areas of sustainability concern: (1) greenhouse gas emissions, (2) energy use, (3) waste to landfill, and (4) paper use. The organization also considers its product stewardship responsibilities. REI aspires to create effective change in the areas of sustainability throughout the industry through the following steps.

REDUCING GAS EMISSIONS/ENERGY USAGE

A major priority in REI's sustainability strategy is to find ways to grow while minimizing greenhouse gas emissions. With climate change at the forefront of environmental concerns, REI has been reducing the impact of its greenhouse gas emissions through methods such as the purchase of carbon offsets. During a one-year period, REI reduced its emissions by 7.6 percent, even as the company increased its sales.

Since the majority of greenhouse gas emissions come from transportation, REI has begun promoting responsible transportation whenever possible, including alternative approaches such as subsidizing vanpools and offering incentives for public transportation. Employee commuting emissions decreased by 27 percent in a one-year period, while product transportation emissions decreased by 9 percent.

The challenge of decreasing greenhouse gas emissions while simultaneously increasing REI business operations requires REI to do more with less energy. One way is through investment in more sustainable energy sources. In 2012 REI installed solar electrical systems at three stores; REI now has solar electrical systems at 26 locations. Success in this area will benefit not only the environment, through lower carbon emissions, but also the company, through additional energy savings.

WASTE AND RECYCLING

REI has set the impressive goal of becoming a zero waste-to-landfill company by 2020. The organization is therefore seeking innovative ways to generate less waste and recycle the waste it does generate. These efforts are focused on the entire supply chain. The idea is to reduce waste before it gets to the retail level. Some of REI's methods include redesigning packaging to reduce packaging waste and increasing recycling. Because REI expanded, its operational waste increased in 2012. The majority of waste from REI that ends up in landfills comes from the company's retail stores. However, its total waste decreased by 1.4 percent.

PAPER USAGE

REI wants to ensure that the paper it uses is sourced responsibly. It is impossible for REI to completely eliminate its use of paper, but the company's paper policy encourages the purchase of paper products sourced from post-consumer waste or virgin fiber harvested from forests certified by the Forest Stewardship Council (FSC). Certification implies that the paper-based products have been responsibly sourced. Although REI saw its paper usage increase slightly in 2012, its use of FSC-certified materials also increased.

INCREASING RESPONSIBLE PRODUCT STEWARDSHIP

Environmental stewardship does not stop after a company sells a product. Some companies believe that once a customer has purchased a product, that product and its subsequent disposal are the consumer's responsibility. However, REI makes product stewardship a key tenet of its sustainability goals. It advocates for a universal standard that can be used to judge a product's sustainability. To that end, REI partnered with Timberland to create the Eco Index. In 2012 the Eco Index was modified to form the HiGG Index, a tool used to measure the sustainability of apparel and footwear products. REI also supports the bluesign® system, a system to responsibly manage chemicals in the supply chain. In 2012 approximately 23 percent of material that REI used was bluesign-certified.

COMMUNITY STAKEHOLDERS

Each year REI supports many local programs to further conservation and outdoor recreation. In order to make the biggest impact, REI invites and engages its members, customers, and entire communities. REI also encourages its employees to volunteer in improving and protecting the outdoors. A primary focus for REI is youth. REI seeks to inspire and educate the younger generation about the outdoors. The company's Promoting Environmental Awareness in Kids (PEAK) program is one step toward youth engagement. PEAK is a result of the collaboration between REI and Leave No Trace Center for Outdoor Ethics. This program teaches kids about outdoor ethics—such as cleaning up waste materials and respecting wildlife—while having fun outdoors. PEAK has two goals: to introduce youth to the wonders of the outdoors, and to practice responsible “No Trace” principles.

REI sets aside three percent of its previous year's operating budget to support nonprofits and other causes that promote outdoor stewardship. In addition to supporting diversity in its workforce, REI encourages diversity in the outdoors. REI has participated in a number of endeavors supporting minority groups, including underwriting Latino USA's “RadioNature” feature in partnership with

Futuro Media Group. The feature described the relationships the Latino population has with the outdoors.

ADVOCACY EFFORTS AND THE REI FOUNDATION

REI's advocacy efforts center on its desire to protect the environment and promote outdoor recreation. The company has lobbied and continues to lobby for public lands and environmental causes. More specifically, the organization has supported the Land and Water Conservation Fund, the Recreational Trails program, and the Outdoor Industry Association. Additionally, REI is involved with the Washington Wildlife and Recreation Coalition.

In 1993 REI founded the REI Foundation, with the mission of encouraging and supporting youth participation in the outdoors. In 2012 the REI Foundation donated \$275,000 to the Outdoor Foundation, Children & Nature Network, The YMCA of the USA, and The Mountaineers.

CHALLENGES IN STAKEHOLDER RELATIONSHIPS

REI faces many challenges in managing its stakeholder relationships, particularly in today's uncertain economic climate. For instance, in 2013 REI laid off some of its workforce at its headquarters, many of which were in the support area of the company. REI has also encountered workforce diversity challenges. Approximately 86.4 percent of the REI workforce describes themselves as white non-Hispanic. This fact could be problematic considering REI's values toward employee diversity as well as in reaching new markets. As a result, REI has stepped up its efforts to create brand awareness among diverse populations through community outreach. It also created a Diversity and Inclusion Awareness and Skills Training for company leaders. Although REI still has room for improvement, the firm received the highest rating possible from Human Rights Campaign's "Corporate Equality Index."

Perhaps the biggest challenge in terms of ethical lapses involves the labor conditions in factories from which REI sources. An independent audit of these factories revealed some violations of REI's factory Code of Conduct. Many of these violations were relatively minor in nature but still call for improvement. The majority of violations dealt with health and safety, followed by working hours and wages/benefits. This is a very important issue for REI, as unsafe working conditions—should they escalate—can create reputational harm for the company. Some of the violations included lack of policies for adequate health and safety and forced overtime. REI plans to increase oversight of its supply chain by establishing more of a presence in China and continuing to improve working conditions, compensation, and a positive work-life balance among factory workers.

REI has also faced challenges with its customers. Although REI has a 100% Satisfaction Guaranteed Policy, it has made some dramatic changes to its policy. Items must now be returned within one year of purchase. Also, the policy does not apply to products that have endured ordinary wear and tear or that have been damaged through improper use or accidents. Items purchased from REI-OUTLET must be returned within 30 days of purchase. This change in policy might be disappointing for consumers, who appreciated REI's liberal return policy. Yet according to the senior vice president for retail, REI has noticed customers abusing the policy, such as intentionally destroying a product and then returning it for a full refund. This has impacted REI's profits. REI has learned the lesson that there will always be some consumers who will take advantage of their policies, requiring them to strike a balance between a generous return policy and guarding against unethical behavior.

CONCLUSION

REI has experienced great success since its founding in 1938. Its unique consumer cooperative business model increases member commitment, and the company has been able to gain a loyal customer following. Moreover, employees give the company consistently high ratings as an employer. REI has backed up its stated commitment toward youth, communities, and the outdoors through philanthropic and sustainability initiatives to improve the lives of its stakeholders.

At the same time, REI will face obstacles in maintaining its current status. The last recession introduced difficulties for REI regarding its employee stakeholders when the company was forced to make cutbacks. REI appears to have handled these cutbacks relatively well as it continues to be voted as one of the best companies to work for. REI must also continue to overcome environmental challenges. The company admits that there is room for improvement and has set high goals for itself. But there are few standards for measuring sustainability, which can be an issue since REI sells many items that it categorizes as ecofriendly. Since there is no standard by which to measure this label, companies like REI must exert caution when promoting a product as green. REI also continues to have waste issues at its retail locations. REI will have to expend resources and adopt innovative solutions in order to be zero-waste by 2020.

Despite these challenges, REI remains a good example of corporate social responsibility. Its stewardship report reflects a stakeholder orientation, or a perspective that encompasses all the different company constituents rather than just investors or customers. REI has proven that ethics, social responsibility, and a powerful vision can help a company to thrive.

QUESTIONS

1. Is REI successful because it is a consumer cooperative or because of effective stakeholder orientation?
2. Who is responsible for managing ethics and social responsibility at REI?
3. Assess REI's ethical and social responsibility risks and suggest how these risks can be managed effectively.

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