A Brief History and Overview of Lululemon

Founded in 1998 as a family-owned startup company by Dennis Wilson, Lululemon rocketed to retail prominence with 14 stores and sales of $40.7 million in January 2005. The company competed using a “grassroot” marketing strategy – relying on social media and word-of-mouth to capture whitespace in the premium yoga apparel market segment. As the company continued to grow, they created the Ivivva brand in 2009, focusing on creating athletic sportswear for active girls between ages 6 – 14. This represented a strategic push to expand into the North American region and cementing their position within the female athletic apparel segment. Lululemon’s rise to capture a dominant stature in the marketplace wasn’t without turbulence. In March 2013, the company took a hit on their release of the female Luon fabric bottoms product line due to widespread complaints of the fabric's revealing nature. To make matters worse, internal friction stemming from the product recall within the executive leadership team, and the controversy created through founder Wilson’s remarks on how the products don’t fit certain female body types left the company in a shaky position. With competitors continuing to flood the market, Laurent Potdevin was appointed CEO in December 2013 to help reinvigorate the Lululemon brand after a series of disappointing earnings. Fast-forward 6 years, the high-tech yoga apparel company generates $2.6 billion in revenue, with 426 stores across 5 continents.

The case sets to present a strategic roadmap for Lululemon to navigate the increasingly competitive specialty-retail landscape. With notable entrants such as Gap Inc. and the dominant incumbent players such as Nike and Adidas, this begs the questions: Where is the strategic

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2 BAMSEC.com. Lululemon Athetica Inc. – 10 Q. Retrieved on 2/28/2019
whitespace in the market and does the opportunity present a complimentary fit with current resources and capabilities?

**Current Situation/Challenges**

Lululemon’s brand equity contributes to the high-margin product sales. Recent surveys have indicated that the company’s customers are less likely to cross shop other brands due to customer loyalty\(^3\). Similarly, limited releases of certain designs create a fear of missing out (FOMO), generating quicker turnover with these products. By keeping tight lines of distribution over their products (B&M stores, limited online) and continuing to acquire majority stakes in third-party distributors abroad, Lululemon has gained control over product distribution.

Lack of online presence has limited Lululemon scope of distribution. Since most Americans don’t live near a Lulu brick-and-mortar store, access to products is restricted heavily. Lulu can increase market share while maintaining brand control through developing their online platform - www.lululemon.com.

The brand has made a successful push into the Chinese market, adopting a city-centric approach towards domestic expansion while selling through Tmall and WeChat – both are options that provide instant access to a broad set of consumers. While expansion in the European market has been less successful, management hopes that growth can be achieved through replicating the city-centric expansion model currently used in China.

The Iviva brand recently completed a restructuring process which lead to the closing of 48 out of the 55 total stores. Iviva brand will continue to sell through e-commerce. While the restructuring process has impacted profitability, Lululemon has experienced margin expansion in the recent quarter attributed to top-line growth and lower product costs.

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\(^3\) UBS Equity Research “Lululemon Athletic Inc. “Management Meeting – It can get better.” Retrieved 2/28/2019
Challenges and opportunities of Lululemon’s macro-environment

Sociocultural factors like consumer attitudes and preferences impact Lululemon’s brand. Within the North American market, sports participation rate is expected to reach 21% in 2020. This combined with the developments in alternative exercises such as CrossFit and Pilates will drive demand for athletic apparel, but also increases the complexity of product development given the birth of new sporting markets. Lululemon makes significant investment into R&D to track consumer preference shifts.

Digitalization of industry-wide value chains provide advantages of dynamic pricing and optimized product replenishment (lower inventory). The introduction of point-of-sale (POS) systems, barcode scanning, and electronic data interchange (EDI) make the process of tracking products throughout the value chain more efficient and decreases costs. China’s digital economy has experiences rapid growth, accounting for 42% of global e-commerce sales. While reinvestment of cash flows into storefronts are necessary, expanding the firm’s e-commerce capabilities is crucial in order to compete in the dynamic Chinese market.

Competitive forces affecting athletic apparel industry and implications for Lululemon

The athleisure industry’s presents a cut-throat environment. While suppliers are fragmented in the market, the middle and front channel of the value chain is dominated by incumbent firms with significant resources. Economies of scope have been the point of emphasis, with large diversified companies leveraging their wide distribution and brand awareness to gain a slice of market share across different products. Given the level of competition, buyers incur low switching cost from switching brands. Social media has increased the overall awareness of
buyers, companies like Lululemon need to present a compelling justification for the high prices charged.

**Supply Chain Analysis** (refer Value Chain Construct in Appendix)

Lululemon adopts a flexible contracting approach to source fabrics and manufacture their products. The company works with 65 suppliers, with 59% of the fabrics provided by the top 5 suppliers. To manufacture the products, Lululemon works with 47 vendors, 5 of which contribute to 64% of the products manufactured. An inspection firm is brought in to assess the viability of working together before any contracts are handed out. The products supplied are largely differentiated, with tech-infused fabrics protected by patents owned by the suppliers. It is in the firm’s best interest to ensure relationships with suppliers are well-maintained, and that their financial interests are looked after due to the high-switching costs Lululemon would incur should a large supplier drop out of the value chain.

**Leveraging the driving forces of Athleisure industry**

The industry driving forces (refer to Appendix) present key considerations to generating a sustainable competitive advantage. Recent collaborations between celebrity influencers and sports apparel brands have demonstrated the ability to increase brand awareness and acquire new customers. Lululemon can leverage the power of sports celebrity endorsements along with their grassroots strategy to expand into different product lines. With increasing new entrants flooding the market, industry-wide output has increased substantially, cutting into the margins of existing players. This trend will likely continue, putting pressure on future margins and driving out firms that are unable to secure their piece of the market. Companies should look to e-commerce platform developments to attract the growing population of digital consumers world-wide. In
doing so, distribution channels will require investments to bolster the ability to supply the increase in demand.

**Market standing of Lululemon**

The market standing of Lululemon is shown in the Strategic Group Mapping Diagram (refer to Appendix). Firms in the market should be assessed using distribution capabilities and perceived quality as key metrics. This paints the picture of how consumers identify with certain brands and how well the brand can meet the demand for their products. From a perceived quality standpoint, Lululemon leads the industry with their highly-differentiated products and pricing signals to indicate quality. Distribution is through licensing and supply arrangements in the Middle East and Mexico, and physical store-fronts in all other countries they operate in. Lululemon lags industry leaders Nike and Adidas on this metric because they have significant financial resources to invest into optimizing their distribution channels. These investments yield fast delivery on online purchases and ideal shelf space in the physical storefronts of forward-channel partners.

**Key success factors in Athletic apparel industry**

The various key success factors affecting the industry and how Lululemon ranks amongst them have been explained in Competitive Strength Assessment model (refer to Appendix). Lululemon lags competitors based on manufacturing capabilities and faces the problem of high bargaining power of suppliers. Lululemon must emphasize distribution capabilities to make sure that faster international expansion and increased distribution capabilities are aligned with strict procedures and inventory management system so gains from capital infusion in international markets can be optimally realized. Lululemon’s business model focuses on selling high-quality products directly to consumers.
**Most Important internal resources and capabilities**

Lululemon has been thriving in the athleisure industry. This is attributed to their brand reputation signaling quality, consistency, innovation and guest experience to consumers. Lululemon has the fourth highest retail revenue per square foot of all companies in the U.S. behind Apple, Tiffany’s and Warby Parker. This is due to their emphasis on inventory turnover and has translated well into strong financial performance. Lululemon has low leverage ratios relative to peers, suggesting the company has yet to capitalize on the full benefits that debt financing could provide for future expansion plans. Lululemon’s ability to differentiate along the value chain has successfully led to Lululemon's success. Capabilities of their forward, and backward channel partners combine to produce a product that consumers are willing to pay a premium for. This is the ultimate contributor to recent growth. However; continuous plowback of earnings into R&D are crucial to maintain their ability to innovate and stay ahead of the market.

**Competitors, Threats, and the Bottom Line**

Despite being an industry innovator, one issue Lululemon faces is that its international market penetration hasn’t grown or expanded at a significant rate. Another threat Lululemon faces is internal leadership problems, in recent history Lululemon has faced internal conflict over many reasons. Notable exits include their previous CEO (Laurent Potdevin), who exited as a result of misconduct charges, founder Chip Wilson who resigned from the board of directors, and additional conflict that have arisen due to recent product recalls. While the company is positioned well for short-term success, the overall outlook is uncertain. The potential for disruptions along global supply chains and increasing product costs demands that Lululemon ensure the executive leadership team functions properly to lead the company through an increasingly complex global environment.
## Appendix

### PESTLE Analysis

<table>
<thead>
<tr>
<th>Key Considerations</th>
<th>Risk</th>
<th>Explanation</th>
</tr>
</thead>
</table>
| Political          | Medium | - Tariffs resulting from administration’s stance on trade policy could impose increasing sourcing costs given 15% of products are sourced from China.
|                    |       | - An international presence exposes companies to different tax laws and effective tax rate can be adversely impacted by differing statutory tax rates and changes in tax laws. |
| Economic           | Medium | - Interest rate hikes (excluding most recent hold decision) by the FED potentially increasing the cost of debt capital financing. |
|                    |       | - Firms like unemployment and lending rate directly affects consumer discretionary income that is directly proportion to what consumer spends on brands like Lululemon. |
| Sociocultural      | High  | - Projected 21% sports participation rate within North America in 2020 to drive demand for sports apparel. |
|                    |       | - Adolescents most active in sports between ages 10 and 19 expected to increase. |
|                    |       | - Developments in alternative exercises (CrossFit, Yoga, and Pilates) potentially drawing new consumers into the market. |
| Technological      | High  | - Introduction of point-of-sale (POS) systems, barcode scanning and electronic data interchange (EDI) enabling extraction and record merchandising databases, sales and stock management via POS system. |
|                    |       | - China’s digital economy has experienced massive growth, accounting for 42% of the global e-commerce market, up from 1% ten years ago. |
| Legal / Regulatory | Low   | - Some states in North America have enacted anti-trust laws to ensure public is provided with choices for quality products at the right price and prevent a dominant player from emerging. |
| Environmental      | Low   | - Climate change potentially causing disruptions to supply chains and distribution channels. |
|                    |       | - Can affect the ability to meet customer expectations, manage inventory and complete sales. |

### Porters Five Forces Model

**New Entrants**
- Strong existing brand preferences established through loyal customers.
- High upfront financial and human capital needs.
- Difficult in building a network of cost-efficient distributors and securing shelf space accessing platforms.
- Strong “network effects” in consumer demand.
- Incumbents willing to launch vigorous initiatives to block newcomers’ successful entry.

**Threat of Substitutes**
- Athletes apparel unlike any commodity-like product requires going through the process of continuous innovation.
- Finding better substitutes in an industry where competitors are sensitive to consumer’s needs is difficult.
- The product isn’t substitutable in nature (apparel).

**Rival Firms**
- Cut-throat competitive environment reducing margins.
- Industry participants have emphasized economies of scope – expanding from product offerings to gain a share of market share across different products.
- Larger diversified companies have larger operating margins, larger customer bases, wide distribution systems, and can achieve brand awareness and market share more quickly.

**Buyer**
- Low Cost to Switch (buyers).
- Requires customers to pay a premium above the average competitive price of goods.
- Informed buyers enabled through technology / social media.

**Substitute Products**
- Suppliers possess high bargaining power given requirements for technologically-advanced fabrics and the lengthy process of establishing strong supplier connections.

**Supplier**
- Products have shifted away from being a commodity to more differentiated tech-infused fabrics.
- High switching costs.
- Intellectual property for tech-infused textiles owned by top suppliers.
- Lower threat of backward integration – contract enables flexibility in product sourcing.
SWOT Analysis

**Strengths**
- Strong brand equity enables to sell products at a high margin relative to industry rivals
- Customers are less likely to cross shop other brands due to customer loyalty
- Successful expansion into China, currently selling through Tmall and WeChat with a city-centric approach towards domestic expansion

**Weakness**
- Recent damage to brand image due to the revealing nature of recent Lululemon brand bottoms
- Internal conflict among senior leadership team as a result of the product recall
- Public statement regarding the fit between the products and certain female body sizes not well-received by public

**Opportunities**
- Implementation of a city-centric approach towards European expansion to further diversify global revenue sources
- Integration of recently-developed data analytics capabilities into the new membership program to increase brand loyalty and personalized marketing ROI
- White space to fill within the pricing spectrum of the outerwear niche between Canada Goose/Moncler and the North Face

**Threats**
- Continuous traffic declines in North America
- Inability to establish a strong online-presence while industry-wide online sales continue to outpace store revenues
- The “athleisure” trend wanes while global tariffs force increases in supply-related value chain activities causing the industry-wide value chain to suffer from margin erosion

Strategic Group Map

**Industry Leaders**
- Strategic Group 1
  - Adidas
  - Nike

**Strategic Group 2**
- Lululemon
- Under Armour

**Strategic Group 3**
- Tapestry Inc.
- Gap Inc.
- Puma
- Li Ning Corp.
## Competitive Analysis

<table>
<thead>
<tr>
<th>Key Success Factors</th>
<th>Weight</th>
<th>Under Armor Rating</th>
<th>Score</th>
<th>Lululemon Rating</th>
<th>Score</th>
<th>Tapestry Inc. Rating</th>
<th>Score</th>
<th>Gap Inc. Rating</th>
<th>Score</th>
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<tbody>
<tr>
<td>Product Quality</td>
<td>20%</td>
<td>9</td>
<td>1.8</td>
<td>10</td>
<td>2</td>
<td>6.5</td>
<td>1.3</td>
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<tr>
<td>Distribution Capabilities</td>
<td>18%</td>
<td>10</td>
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<td>Manufacturing Capabilities</td>
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<td>5</td>
<td>0.05</td>
<td>5</td>
<td>0.05</td>
<td>5</td>
<td>0.05</td>
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<tr>
<td>Reputation / Image</td>
<td>13%</td>
<td>10</td>
<td>1.3</td>
<td>10</td>
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<td>10</td>
<td>1.3</td>
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<td>Innovation Capabilities</td>
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<td>0.72</td>
<td>8</td>
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<td>Time-to-market</td>
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<td>Financial Resources</td>
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<td>Customer Service Capabilities</td>
<td>1%</td>
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<td>0.08</td>
<td>7</td>
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<td>E-commerce Presence</td>
<td>14%</td>
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<td>5</td>
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<td>Marketing Capabilities</td>
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<td>Product Technologies</td>
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<td><strong>Sum of Weight</strong></td>
<td>100%</td>
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<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td><strong>Weighted Overall Strength</strong></td>
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<td>8.98</td>
<td>8.16</td>
<td>8.05</td>
<td>7.30</td>
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</tbody>
</table>

### Value Chain Construct

**Product Design & Development**
- Led by a team of designers based in Vancouver, British Columbia
- Partner with various international designers
- Team includes athletes and users of company’s products
- Gather ideas from store customers and fitness ambassadors to improve products
- Market intelligence factored into the fabric selection, new product development and design process
- Design team works closely with apparel manufacturers to incorporate innovative fabrics
- Occasional meetings in various geographical markets to discuss products with local athletes

**Fabric Manufacturer**
- 65 fabric manufacturers in total
- No long-term contracts established, relationships are based on order-by-order basis to allow for flexibility

**Garment Producers**
- 35 contract manufacturers in total
- 5 of which produce approximately 62% of the products
- Transact on a order-by-order basis to allow for flexibility

**Third-Party Logistics Providers**
- Provides warehousing and distribution of final goods to HK, China, and the Netherlands

**Distribution Facilities**
- Distribution Center 1 (owned) 307,000-square-foot in Columbus, OH
- Distribution Center 2 (leased) 145,000-square-foot in Vancouver, BC
- Distribution Center 3 (leased) 110,000-square-foot in Vancouver, BC
- Distribution Center 4 (leased) 150,000-square-foot in Summer, WA
- Suppliers stores in Canada, US, and some European locations
- Distribution Center 5 (leased) 55,000-square-foot in Melbourne, AU
- Suppliers stores in Australia and New Zealand
Athleisure Industry Driving Forces Overview

**2019 Short-Term Drivers**
1. Collaboration with celebrity influencers to drive brand recognition and appeal to younger consumers
2. New entrants to the market to increase industry output and competition
3. Tech-infused materials to drive product appeal
4. Global Supply Chain Development

**2020**

**2021 Long-Term Drivers**
- Brand influencers will determine the strength of a brand’s “network effect” that helps attract younger consumers to establish a strong customer base.
- As the industry starts to saturate, pressure on margins will force competitors that fail to drive efficiencies within their respective value chains out of the market.
- Companies that fail to innovate will suffer from declining sales as consumer preferences continue to evolve leading to a demand for products that deliver on both performance and aesthetics competitive to current standards.
- Companies will look towards e-commerce platforms to establish global reach and appeal to the growing population of digital consumers while investing to bolster their forward-channel partners’ distribution capabilities.

### VRIN Model

<table>
<thead>
<tr>
<th>Resource</th>
<th>Valuable</th>
<th>Rare</th>
<th>Inimitable</th>
<th>Non-Substitutable</th>
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<tbody>
<tr>
<td>lululemon</td>
<td>✔️</td>
<td>✔️</td>
<td>✔️</td>
<td>✔️</td>
</tr>
<tr>
<td>Educators/Brand Ambassadors</td>
<td>✔️</td>
<td>✔️</td>
<td>✔️</td>
<td></td>
</tr>
<tr>
<td>Distribution</td>
<td>✔️</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Evedux &amp; ABC Brands</td>
<td>✔️</td>
<td>✔️</td>
<td>✔️</td>
<td></td>
</tr>
</tbody>
</table>
Internal Performance Overview

Leadership Recent Developments

- Internal conflict as a result of recent product recall
- Recent CEO (Potevin) exit as a result of misconduct changes
- Founder Chip Wilson resigned from the Board
- Calvin McDonald appointed the new CEO to help the company navigate a period of international expansion and culture rehabilitation

Geographic Sales Performance

- United States
- Canada
- Asia, Australia, and New Zealand
- Other

Financial Summary

- Revenue: $2,649M
- LTM Growth: 12%
- Net Income: $318M
- Net Margin: 12%

Performance Highlights

- Boast the fourth highest retail revenue per square foot of all companies in the U.S. behind Apple, Tiffany’s and Warby Parker
- Emphasis on inventory turnover has translated well into strong financial performance
- Successfully acquired ownership stakes in international distribution channels
- Low leverage ratios suggest the company has yet to capitalize on the full benefits debt financing has to provide
- High rates of return on invested capital and return on equity to create value for existing shareholders