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Patagonia

[Patagonia] is business conducted upside down and inside-out. Everything about it flies in the face of consultants' recommendations about How to Maximize Profits and Cut Costs. Simply put, it's radical.

—Fortune Magazine[1]

It's okay to be eccentric, as long as you are rich; otherwise you're just crazy.

—Yvon Chouinard, Founder of Patagonia, Inc.[2]

In the spring of 2010, Casey Sheahan, CEO of Patagonia, and senior executives were in intense discussions about the future of the company. They were wrestling with the challenge of implementing a new, radical environmental initiative that was at the forefront of their agenda.

At the time, Patagonia was known as a worldwide leader of environmentally responsible business. Forbes magazine named it "the do-no-evil" outdoor-apparel company,[3] and Fortune Magazine described how founder Yvon Chouinard turned "his passion for the outdoors…into an amazing business."[4] While maintaining an average annual growth of 6% in net sales, Patagonia donated 1% of its revenues to environmental causes, provided in-kind donations to environmental groups, and invested thousands of dollars into reducing the environmental impact of its production process. Meanwhile, the company was targeting a 10% annual growth in sales for the next five years.[5]

Sheahan and executives worried that this new initiative could threaten their delicate balancing act between committing to sustainability while achieving 10% revenue growth. The "Product Lifecycle Initiative" would expand existing practices such as repairing and recycling old garments, while establishing a swap market of used products for its customers. Most radically, the initiative would include telling its customers to buy less and think twice before they purchased a garment.

From very early on, Chouinard had been "tormented by the realization" that his own company might be responsible for overconsumption, and called out to customers to reduce their consumption in a reflection in 1995[6] and again in a 2004 catalog essay.[7] He worried that Patagonia could "never be completely socially responsible," and this anxiety motivated Chouinard to push Sheahan to implement this new initiative.[8]

As Sheahan and executives attempted to carry out Chouinard's vision, Patagonia faced challenges from consolidating retailers and fast-growing competitors in the outdoor apparel industry. Still, Chouinard asserted, "I'm kind of like a Samurai. They say if you want to be a samurai, you can't be afraid of dying, and as soon as you flinch, you get your head cut off. I'm not afraid of losing this business."[9]

Professors Forest Reinhardt and Ramon Casadesus-Masanell and Research Associate Hyun Jin Kim prepared this case. HBS cases are developed solely as the basis for class discussion. Cases are not intended to serve as endorsements, sources of primary data, or illustrations of effective or ineffective management.

Patagonia's History: a "dirtbag" business

The Beginnings of a Businessman

A world-class mountaineer known for several impressive ascents, Chouinard described himself not as a businessman, but a "dirtbag," his term for someone who wandered through "temp jobs and long summers," pursuing a life of climbing in Yosemite and surfing in Baja.[10] Spurred by the desire to make stronger, better climbing equipment for himself and his friends, Chouinard started a business making pitons (pegs used in mountain climbing) in 1957. As demand for his gear grew, the back-of-the-car operation eventually transformed into Chouinard Equipment. In 1966, Chouinard set up shop in Ventura, California, for its proximity to surf breaks, and began a partnership with his peer climbers, Tom and Doreen Frost.[11]

Chouinard Equipment became the largest supplier of climbing hardware in the United States by 1970, but as Chouinard recalled, "None of us saw the business as an end in itself. It was just a way to pay the bills so we could go off on climbing trips."[12] Tom and Doreen would work while Chouinard took six months surfing down the west coast of the Americas, skiing in Chile, and climbing in Argentina. In return, the next year, Chouinard would watch the business while Tom climbed the peaks in the Himalayas.[13]

Patagonia's Early Years

In 1972, Chouinard Equipment added an apparel line named "Patagonia" after a mountainous region in Chile and Argentina. Soon after, Chouinard's partnership with the Frosts came to an end. Patagonia was established as its own company in 1979, and Kristine McDivitt Tompkins, an avid ski-racer and fellow "dirtbag," was appointed its first CEO. Lost Arrow Corporation was created in 1984 as a parent company for Chouinard's businesses.[14] During the 1980s, while Chouinard Equipment experienced legal trouble and was eventually sold, Patagonia grew its sales from $20 million to $100 million and expanded internationally to Europe and Japan.[15] Although the early 1990s recession triggered a sales crunch and layoffs of 20% of its workforce, sales at Patagonia continued to grow, albeit erratically, throughout the 1990s, at 6.7% compounded annual basis from 1989 to 1999.[16] By 2000, the company was grossing about $200 million in net sales. (See **Exhibit 1** for Patagonia's financials.)

Business Philosophy

Chouinard stated that he would "never be happy playing by the normal rules of business."[17] He saw business as deserving much of the blame for many of the world's economic, social, and environmental problems. However, he believed that business had the potential to alleviate these problems and inspire positive change. For Chouinard, Patagonia represented an "experiment" to "challenge conventional wisdom and present a new style of responsible business."[18]

Expressing that he wanted to "distance [himself] as much as possible from those pasty-faced corpses in suits," Chouinard asserted, "If I had to be a businessman, I had to do it on my own terms."[19] He firmly believed in Zen philosophy, which he saw as "perfect" for the business world. He explained, "In Zen archery…you forget about the goal—hitting the bull's-eye—and instead focus on all the individual movements involved in shooting an arrow. . . . If you've perfected all the elements, you can't help but hit the center of the target." Applying this philosophy to Patagonia, he oriented its goal away from profits and toward "doing things right."[20]

Chouinard also applied to his business important lessons he had learned from climbing the likes of Yosemite's El Capitan. In particular, Patagonia's environmental commitment arose from Chouinard's own experience observing the damage done to the rocks while climbing. Furthermore, he asserted that he learned to make business decisions "as risk-free as possible" through climbing, which he saw as being inherently about risk-management. He described, "You can't control the event of an avalanche. But you can study the conditions of your climb, prepare, and train for it."[21] For Chouinard, the same applied to business.

These principles guided a vision for Patagonia that was articulated in its mission statement: Patagonia strived to *build the best product, cause no unnecessary harm, and use business to inspire and implement solutions to the environmental crisis.*[22]

Sheahan asserted that "the values of the mission statement [were] entrenched in the walls of Patagonia, in every employee and every decision."[23] For example, the environmental component of its mission spurred Patagonia to remove anti-odor chemicals from its products in 1998, due to environmental and public health concerns. Although the market for anti-odor clothing was growing at the time, Patagonia did not adopt any anti-odor technology until 2004 when it found an environmentally benign one made from crushed crab shells.[24]

Governance

In spring of 2010, Patagonia was Lost Arrow Corporation's only significant wholly owned subsidiary, and Yvon and Malinda Chouinard remained Lost Arrow's only shareholders. Some observers suggested that the fact that Patagonia was private was a major reason that it could pursue environmental sustainability, arguing that its sustainable agenda was at the expense of its growth.[25] Patagonia committed to the view that its environmental decisions were not at odds with optimal financial performance.[26]

Patagonia experienced rapid turnover in senior management throughout the 1990s and 2000s. After Kristine McDivitt Tompkins's retirement as CEO in 1993, the position changed hands multiple times.[27] In 1999, Michael Crooke was appointed CEO of both Lost Arrow and Patagonia. Crooke left the company in 2005, and was replaced by Casey Sheahan, a long-time friend of the Chouinards. Commenting on the turnover, Chouinard explained, "We've rushed through a lot of CEOs and a lot of management teams that didn't understand what we're about….The values here are so deep…[and] it is hard to find a CEO that will grow with the company."[28]

Although Chouinard did not occupy any official executive position in the company after he retired as CEO in 1999,[29] he continued to play a large role in all company decisions, from the details of product development to broad strategies concerning the direction of the company. Chouinard practiced what he called his MBA theory of management—a "management by absence"—primarily dedicating his time to climbing, surfing, and wear-testing the clothing and equipment in exotic field locations.[30] Sheahan explained that Chouinard was "the visionary" of the company who traveled the world and came back with ideas, while Sheahan "translate[d] his vision and execute[d] day-to-day the scale-up and globalization of the business."[31] Chouinard articulated that "the board [drove] the change at Patagonia, not the CEO."[32] The board included Yvon and Malinda, their two children, and Kristine McDivitt Tompkins.

Throughout the late 2000s, Patagonia steadily grew its sales at an average rate of 6% per year. (**Exhibit 2** provides financial data for Patagonia and its competitors, and **Exhibit 3** shows Patagonia's balance sheet for FY 2010.) Looking to the future, Sheahan expressed a target goal of 10% annual growth in sales for the next five years. He suggested that better inventory management would spur increased growth, explaining that Patagonia's shortage of inventory caused an inability to satisfy the existing demand for many of its products.[33]

Business of Patagonia

Product Line and Product Development

Patagonia's competitors in the high-end outdoor apparel industry included The North Face, Inc., Marmot Mountain Ltd., Mountain Hardware, and ARC'TERYX. Patagonia's product line was composed of four main product categories: Sportswear (casual clothing including cotton shirts), Technical Outerwear (insulation garments such as technical shells), Technical Knits (baselayers with special fabric treatment), and Hard Goods (packs, luggage, and accessories). Sportswear accounted for about 47% of revenue, Technical Outerwear 30%, Technical Knits 12%, Hard Goods 6%, and other miscellaneous goods 5%. As a percentage of sales, the gross margin for Patagonia's product lines ranged from 50% to 55%.[34] In developing its products, Patagonia primarily focused on three criteria: quality, environmental impact, and innovation. Patagonia claimed that these elements allowed it to charge prices roughly 20% higher than those of other outdoor apparel and 50% higher than mass-market brands for comparable products in both performance wear and sportswear.[35] Patagonia consumers had a median age of 38 years and an average household income of $160,000.[36]

Emphasis on quality Patagonia built products for its "core users," those who led the "dirtbag" lifestyle.[37] To create quality products for these users, the company sought to create products that were simple, functional, and multifunctional. Simplicity was Patagonia's principal design concept, inspired by the French aviator Antoine de Saint Exupéry's statement, "Perfection is finally attained not when there is no longer anything to add, but when there is no longer anything to take away."[38] Chouinard further explained the elements of Patagonia's standard for quality: "Our goal is to offer only viable, excellent products that are as multifunctional as possible so a customer can consume less but consume better. A ski jacket should work perfectly for all disciplines of skiing, but… you should be able to wear it on a sailboat or in a winter rainstorm in Paris."[39] In order to ensure excellence in quality, Patagonia spent $100,000 annually on field-testing.[40] Field-testing was performed by "ambassadors," professional athletes of outdoor sports who assessed the product's design, fabric, performance, and functionality, on a part-time contract basis.[41] (**Exhibit 4** shows an example of the work of Patagonia's ambassadors.) Patagonia updated models only every couple of years, to ensure that each product had a distinct function and represented a significant improvement from older models.[42]

Environmental impact Patagonia was committed to reducing the environmental impact of its products at every step of the production process. From choosing less environmentally damaging dye to reducing packaging, the company made many business decisions based on environmental considerations.[43] For example, in spring 1996, Patagonia made a major decision to manufacture all of its cotton products, which made up one-fifth of its business, from organically produced cotton, due to the greater environmental footprint of conventionally grown cotton. The cost of goods increased, forcing Patagonia to raise the price of its cotton products. Limited availability of organic cotton also led to a reduction of its product line from 91 styles in 1995 to 66 in 1996.[44] Despite losses in profit during the first few years of implementation, Patagonia committed to its decision of using organic cotton. (See **Appendix A** for more information on Patagonia's switch to organic cotton.)

Innovation Patagonia was an industry leader in technological innovation. Patagonia invested $3 million annually in research and development, which included maintaining a laboratory to develop and test raw materials. In the Patagonia lab, engineers worked on projects like developing more durable fabrics or making zippers 100% recyclable. As a result, Patagonia had pioneered many fabrics adopted across the industry. Martijn Linden, Director of Design, explained that the designers worked with an entrepreneurial spirit, with the philosophy that there were no ridiculous ideas.[45] Over the years, Patagonia had patented numerous technologies and designs, such as Synchilla (recycled polyester fleece), Capilene (moisture-wicking polyester fabric), and most recently, a wetsuit lined with chlorine-free wool for increased insulation.[46]

Production and Logistics

Patagonia's choice of business partners was driven by values, "not [by] commercial efficiency."[47] The company held its suppliers to its own standards of quality and social and environmental responsibility. Lisa Pike Sheehy, the Environmental Programs Director, explained, "Patagonia doesn't stop with its own company. It also expects dealers and suppliers doing business with it to join One Percent for the Planet and cooperate on an environmental project."[48] In addition to formal contracts and audits of supplier practices, in 2007, Patagonia signed on to Bluesign Technologies, a textile standard that evaluated the environmental impact of dye and finish chemicals.[49] Executives at Patagonia hypothesized that its selectivity of suppliers led to lower defect rates for its products.[50]

One-third of the cost of Patagonia goods came from manufacturing, while the remaining two-thirds came from raw materials. In 2010, the company worked with 41 suppliers worldwide, trimmed down from the 200 it worked with in 2003. It outsourced 85% of its manufacturing to facilities located outside North America, a geographical breakdown consistent with the industry norm.[51] Labor costs in North America were estimated to be anywhere from four to ten times those elsewhere.[52] From its contractors, Patagonia ordered between 2,000 and 5,000 units per style.[53] 80% of Patagonia's cost of raw materials was accounted by fabric, and the remainder by accessories like buttons and zippers. The company estimated that its fabric costs for performance wear were 10-15% higher than those of its competitors.[54]

Suppliers shipped products to a distribution center in Reno, Nevada, a location chosen partly for its access to a "multitude of outdoor recreational opportunities" like kayaking and climbing. The center packaged and shipped all orders, and also operated as a service center.[55] Patagonia offered an Ironclad Guarantee to repair, refund, and replace any product that did not meet the customer's satisfaction. While most competitors offered a similar 100% satisfaction guarantee, virtually none repaired products, a service that cost Patagonia $350,000 annually to repair more than 12,000 garments.[56] The company's return rate was about 2.6% for the wholesale business and 12.9% for the direct business,[57] both of which were estimated to be much lower than their respective industry averages.[58]

Sales

In both United States and international markets, Patagonia pursued four sales channels: wholesale (~44% of sales), retail (~33%), catalog, and internet (~23% combined). The wholesale and direct channels sold nearly 100% of the product line, while the retail channel offered an estimated 80%.[59] (See **Exhibit 5** for Patagonia's sales and margin by geographic market.)

Patagonia's North American wholesale channel distributed to about 900 to 1,000 dealers, comprised of small, single-store retailers, as well as national store chains such as Recreational Equipment, Inc. and Eastern Mountain Sports.[60] In comparison, Columbia Sportswear Company distributed its products in North America to over 4,000 dealers, including department store chains and other mass-market retailers to which Patagonia did not distribute.[61] Dealers chose which Patagonia products to carry, and all sold products from Patagonia's competitors. Dealers received about 50% of the suggested retail price on the majority of Patagonia products.[62] In FY 2010, Patagonia's wholesale channel generated approximately $145 million in sales and had a gross margin greater than 45%.[63]

Patagonia owned 26 retail stores in the United States and a total of 52 worldwide.[64] For Patagonia, the retail store represented not merely a place for commercial transaction, but a physical representation of the brand. As such, it pursued environmental initiatives, such as grant awards for local environmental organizations and movie screenings. Robert Cohen, VP of Retail, explained that Patagonia wanted customers to form a connection to the store beyond commerce. He emphasized, "The store is a place where the community can gather and feel like it's your shop, not just a place to buy something."[65] Collectively, the retail stores earned over $100 million in sales, with a gross margin of over 65%.[66]

Patagonia's direct channels each earned gross margins of over 68% on sales of approximately 75 million.[67] The company's catalogs were distinctive from its competitors, with only 60% devoted to "selling space" compared to other firms' 90-95%. The remainder of the space in Patagonia catalogs advocated a lifestyle: essays, environmental advocacy, and photographs of beautiful scenery and hardcore athleticism decorated the pages.[68] (See **Exhibit 6** for an example of Patagonia's catalogs.) The website also showcased these pictures, with specific home screen images targeted at certain types of customers based upon browsing and purchase history. In 2010, tens of thousands of people visited Patagonia's website each day.[69]

Marketing

Patagonia spent less than 1% of sales on marketing and advertising, far less than most apparel companies.[70] Considering its sales channels and social media outlets as platforms to communicate its vision to the public, many of its advertising incorporated educational messages for its consumers, dealers, and staff.[71] (See **Exhibit 7** for an example of Patagonia's advertisements.)

Patagonia was against using the company's environmental position as a marketing tool to encourage customers to increase consumption. While informing customers of environmental initiatives, the company made an effort to be "judicious and consistent" in articulating Patagonia's impact.[72] An interactive guide on its website called The Footprint Chronicles tracked the environmental impact of 150 products from design to delivery, showing both the good and bad of Patagonia's operations. (See **Exhibit 8** for an example of The Footprint Chronicles.) The website announced, "We're keenly aware that everything we do as a business—or have done in our name—leaves its mark on the environment."[73]

However, the environmental position of the company attracted much attention from the media and the public. The company received free publicity from the press, such as in 1994 when its production of Synchilla fleece made from recycled soda bottles generated "five-million-dollars worth" of press for the company.[74] Chouinard articulated, "We believe the best way to get press is to have something to say…What works best for us are paid announcements for a new store opening or to create environmental awareness of a specific issue."[75]

The company also received free publicity thanks to other companies. For example, Chouinard was asked to appear in a commercial for the American Express Members Project, broadcasted on ABC during the 82nd Academy Awards. The commercial showed a one-minute video of Chouinard who spoke about Patagonia's history and advocated the removal of the Matilija Dam in Ventura, California.[76] While the commercial cost approximately $2.8 million to $3 million for American Express, many viewers mistakenly perceived it as a Patagonia advertisement.[77] Chouinard donated all of his proceeds to four environmental groups.[78]

Not all attention that Patagonia received was positive, however. The company's publicly announced political position on certain environmental and social issues sometimes incurred controversy, such as in 1990 when conservative groups boycotted Patagonia due to its support for Planned Parenthood. Rather than withdraw its support, Patagonia donated ten dollars to the organization for every picketer who showed up at its stores, in his or her name.[79] The company's renowned ambassadors also drew public interest. In 2007, Patagonia received negative media attention due to ambassador Dean Potter's controversial climb of Delicate Arch, a famous natural landmark located in Utah forbidden to climbers due to conservation reasons. Initially, Patagonia issued a statement taking "no position" on the climb, asserting, "Dean is at the pinnacle of free solo climbing, makes decisions for himself, and has our complete support."[80] However, after much public outcry, a year later, Potter no longer remained an ambassador of the company.[81]

Human Resources

Patagonia considered it essential that employees shared the values of the company. Employees were chosen based on "dirtbag" characteristics, environmental concern, and entrepreneurial spirit, more than traditional academic or business credentials.[82] Chouinard explained, "You can teach a dirtbag how to do business, but you can't teach an MBA grad how to climb."[83]

The corporate culture reflected the company's environmental ethos. At the company headquarters, surf conditions were written up on the board daily, and employees took time off from regular working hours when the surf was up. Every building owned by the company was engineered in an environmentally efficient way, with solar panels, energy efficient lighting, and natural heating and cooling systems. The cafeteria in Ventura showcased organic, mostly vegetarian options for its staff.[84]

The company also offered many environmental benefits to employees, such as paid sabbaticals of up to two months to work for environmental organizations of their choice. Other unconventional benefits included a $2,000 subsidy for those purchasing hybrid cars[85] and bail payment for employees who were arrested during nonviolent expressions of activism for environmental causes.[86]

Sharing a love for the outdoors and the natural environment, employees likened the company to a "family," rather than a group of co-workers. Employees often went on off-site meetings in the mountains or by the ocean,[87] climbed together on weekends, and traveled to Patagonia, Chile, as part of a company program to help create a national park.[88] The headquarters had one of the first on-site childcare facilities, the Great Pacific Child Development Center, built in 1984 at Malinda Chouinard's insistence. The center maintained a low child to caregiver ratio while charging 20% less than other programs. It created a family-friendly workplace, with a playground located right next to the office building.[89] Patagonia was also one of the first companies in America to provide both maternity and paternity leave.[90]

Patagonia was on many "best-company-to-work-for" lists, by sources like Fortune Magazine and Working Mother's Magazine.[91] The company received about 10,000 resumes annually for fewer than 100 available positions.[92] As of July 2007, the Ventura headquarters experienced less than 5% turnover, and 53.5% of Patagonia's overall staff of 1,400 had worked there for more than six years.[93] Sheahan commented, "People in this company would run through walls for [Chouinard]."[94]

Patagonia's Environmental Commitment

Patagonia saw its commitment to the environment as being of primary importance to its mission. Sheahan asserted that the most important part of Patagonia's mission statement was to provide and implement solutions for the environmental crisis. He explained that all business decisions were driven by that final objective, even though many environmental goals were expensive, difficult, and time-consuming.[95]

Patagonia's Environmental Philosophy

Patagonia's environmental initiatives fit into a five-pronged philosophy: "(1) Lead an examined life; (2) Clean up our own act; (3) Do our penance; (4) Support civil democracy [by supporting environmental campaigns and groups]; (5) Influence other companies."[96] Patagonia gave $3,816,750 in grants and in-kind donations in FY 2009. (See **Exhibit 9** for data on Patagonia's historical giving and **Exhibit 10** for details on its environmental commitment in FY 2009.) Most of its giving was as part of its commitment to 1% for the Planet, an alliance of over 1,200 businesses in 38 countries that donated a self-imposed environmental tax of 1% of revenues to environmental organizations worldwide. In addition to grants, Patagonia made in-kind donations, providing various services and donating about $200,000 worth of its products annually to environmental groups.[97]

Patagonia constantly endeavored to improve the environmental impact of its processes. The company examined every step of its manufacturing process to focus efforts on the most important areas in terms of environmental impact. Jill Dumain, Environmental Analysis Director, explained, "Through The Footprint Chronicles, Patagonia [found] that transportation makes up about 1% of its overall energy use. Had we listened to the current media buzz touting transportation as the largest factor in energy consumption, we might have greatly misplaced our efforts."[98] Patagonia also operated energy-efficient buildings and observed office recycling practices, recycling more than 96% of the waste stream at the Reno Distribution Center[99] and reducing paper use even as the circulation of catalogs increased by 65%.[100]

Product Lifecycle Initiative: "Reduce, Repair, Reuse, and Recycle"

In spring of 2010, Patagonia was planning to launch a unique environmental initiative called the Product Lifecycle Initiative. This initiative was seen as an extension of Patagonia's Common Threads Recycling program, which launched in 2005 and recycled products made from Polartech fleece products—of any brand—and organic cotton.[101] The Product Lifecycle Initiative represented a holistic commitment to lengthen the lifecycle of each product and reduce landfill waste.[102] It constituted Patagonia's efforts to take responsibility for the products it made, "from birth to death and then beyond death, back to rebirth."[103]

The initiative was a unique effort to include consumers in Patagonia's vision of environmental responsibility. An internal document articulated that reducing Patagonia's environmental footprint required a pledge from both the company and its customers. The initiative thus consisted of a mutual contract between the company and its customers to "reduce, repair, reuse, and recycle" the apparel that they consumed.[104]

Most radically, the company would encourage customers to limit their consumption to only essential products and to take responsibility for that consumption by choosing well-made garments with the smallest possible footprint and caring for them in an environmentally conscious way. For its part, Patagonia pledged to make high-quality goods that were multifunctional and repairable, provide an ironclad guarantee, be transparent about environmental practices, and provide information about how to best care and clean Patagonia's products.[105]

The initiative included other components as well. Customers were asked to repair their product as many times as possible to lengthen its lifetime, and once they no longer wanted it, to facilitate its reuse by giving it away, swapping, or reselling it. In order to fully support the reuse of products, Patagonia planned to establish an online swap market, hold retail swap events, and donate still useful products to environmental activists and charities. Finally, once an item was too worn-out for any use, and all other options were exhausted, customers were asked to return it to Patagonia to recycle it in the most efficient way.[106] For all repair and recycle requests, Patagonia promised to provide postage-paid return.[107]

The details of implementing this initiative were still undetermined. Senior executives considered offering a membership to the initiative, available for sign-up at checkout or online. They wanted to carefully craft the offer so it would not be perceived as a sales gimmick. In order to remind consumers of their partnership, each Patagonia garment would carry a tag about the initiative. To create an online swap market, Patagonia considered partnering with eBay or Mountain Equipment Cooperative (a Canadian outdoor retailer).[108]

In planning for this initiative, Patagonia saw several potential upsides for its business, such as increased publicity and the acquisition of new customers drawn to the initiative.[109] VP of Environmental Initiatives Rick Ridgeway, a world-famous alpinist like Chouinard, expressed that once launched, he believed the initiative would be "ripe for social media," with a strong chance of "going viral."[110]

However, executives at Patagonia acknowledged that this initiative dialed up many tensions within the company. In particular, despite the company's emphasis on its environmental commitment, profitability and growth of the business were still important. Chouinard explained, "If we wish to lead corporate America by example, we have to be profitable. No company will respect us, no matter how much money we give away or how much publicity we receive for being one of the '100 Best Companies,' if we are not profitable. It's okay to be eccentric, as long as you are rich; otherwise you're just crazy."[111]

The initiative would increase costs and could limit "what might otherwise be additional sales opportunities and growth that [Patagonia] needed to increase profitability."[112] Furthermore, although the "repair" and "recycle" initiatives were extensions of existing services, they would increase Patagonia's costs by at least $60,000 in the first year of implementation.[113] In addition to increasing expenses for inbound shipping, these services required a significant investment to increase capacity. As of June 2010, the repair department was not staffed to handle even the existing rate of returns, and stores were encouraged to offer replacement before repair in order to reduce the wait time for customers. In order to accommodate a higher number of returns that might arise with the implementation of the Product Lifecycle Initiative, Patagonia needed to increase its repair staff or develop relationships with third-party regional repair centers. Expanding its recycling program also placed new demands for staff and storage capacity, as its existing capacity only allowed for the recycling of half the tons of garments collected. Moreover, increasing the percentage of recyclable products from 65% of products in June 2010 to 90% in spring 2011 required further investment in research and design.[114]

These potential consequences depended in part on customer response. Some executives suggested that telling customers to reduce, repair, reuse, and recycle would have no practical impact on consumer behavior, and thus no tangible impact on Patagonia's business. Others hypothesized that a call for responsible consumption could make Patagonia products a more attractive choice due to their quality, durability, and environmentally conscious production, without drastically increasing the return rates for repair and recycling.[115]

Despite these challenges, Ridgeway stated that Patagonia was committed to implementing the initiative, citing that the company's history showed that making decisions in favor of environmental reasons always proved to be a good business in subsequent years.[116]

Serving as a Model for Business

Sheahan suggested that in pursuing environmental initiatives, Patagonia continually assessed how proprietary or inclusionary it was making its practices, because of the tension between its mission to help solve the environmental crisis by serving as a model for business and its need to maintain profitability and competitive advantage.[117]

For the Product Lifecycle Initiative, Patagonia considered providing services for other companies' products. The company already recycled all Polartech fleece, regardless of brand. In pursuit of its mission, it could repair other brand's products and allow them to be sold on its swap market as well. As Sheahan expressed, however, Patagonia had to still consider its own business.[118]

Patagonia's leaders asserted that its environmental commitment gave the company its competitive advantage, but also felt that its mission obligated the company to share broad sustainability practices.[119] It gave advice to companies like Nike and Gap about using pioneered technology like organic cotton in the 1990s, and inspired numerous companies, from smaller enterprises like Clif Bar to larger ones like Levi Strauss, to adopt environmental practices.[120] Even senior executives at Wal-Mart visited Patagonia from Bentonville, Arkansas to discuss with Chouinard and Ridgeway lessons from their strategy.[121]

Chouinard saw it as a mark of success that other companies were making changes.[122] However, executives added that other companies' following suit put pressure on Patagonia to continually innovate.[123] Director of the Reno Distribution Center Dave Abeloe explained that Patagonia stopped making plain white organic cotton T-shirts "as more and more companies began offering [them]."[124] To rise to the challenge, Patagonia continued to develop numerous technology and design patents for its own products.[125]

Patagonia was focused on continuing on its path of breaking new ground in reducing environmental harm. Ridgeway emphasized, "Sustainability is a bullshit term unless you live in a cave. We're never going to get down to zero environmental impact—if you think we're making clothing and saving the planet, you're wrong. There are no perfect solutions. We don't want to externalize the harm that we're producing, but continue to do our part in reducing it as much as possible."[126]

Exhibit 1 Lost Arrow Corporation Financials (in $000)

	FY 2002	FY 2003	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010**
Net Sales	220,344	218,861	233,381	241,896	261,878	275,941	296,079	314,522	332,862
% Change		*-1%*	*7%*	*4%*	*8%*	*5%*	*7%*	*6%*	*6%*
Gross Margin	104,929	110,278	118,631	123,518	126,839	133,417	147,169	160,198	175,125
% Change		*5.1%*	*7.6%*	*4.1%*	*2.7%*	*5.2%*	*10.3%*	*8.9%*	*9.3%*
% of Sales	*47.6%*	*50.4%*	*50.8%*	*51.1%*	*48.4%*	*48.3%*	*49.7%*	*50.9%*	*52.6%*
SG&A Expenses	83,168	85,862	98,951	106,225	113,141	121,111	128,878	141,275	148,162
% Change		*3.2%*	*15.2%*	*7.4%*	*6.5%*	*7.0%*	*6.4%*	*9.6%*	*4.9%*
% of Sales	*37.7%*	*39.2%*	*42.4%*	*43.9%*	*43.2%*	*43.9%*	*43.5%*	*44.9%*	*44.5%*
Operating Margin *	21,761	24,416	19,680	17,293	13,698	12,306	18,291	18,923	26,963
% Change		*12.2%*	*-19.4%*	*-12.1%*	*-20.8%*	*-10.2%*	*48.6%*	*3.5%*	*42.5%*
% of Sales	*9.9%*	*11.2%*	*8.4%*	*7.1%*	*5.2%*	*4.5%*	*6.2%*	*6.0%*	*8.1%*

Source: Patagonia, Inc., internal company documents.

*Operating Margin = Gross Margin – SG&A.

**FY 2010 financial results as of April 30, 2010 are unaudited results.

Exhibit 2 Patagonia and Selected Competitors: Financial Data

	Columbia Sportswear	V.F. Corporation*	Nike	Timberland	Patagonia**
Date	*Dec.2009*	*Dec.2009*	*Dec.2009*	*Dec.2009*	*Jun.2010*
Annual Sales ($ million)	1,244	7,220	19,176	1,286	333
Employees	3,113	45,700	34,300	5,700	1,400
Market Value ($ million)	1,727	8,872	36,112	1,022	N/A
Gross Profit Margin	42.5%	44.3%	45.2%	47.8%	52.6%
Pre-Tax Profit Margin***	7.2%	9.1%	12.4%	7.9%	8.9%
Net Profit Margin	5.5%	6.4%	9.3%	5.1%	N/A
Return on Equity	7.2%	12.5%	19.6%	11.3%	9.6%
Return on Assets	6.1%	7.1%	13.4%	8.5%	7.1%
Total Debt/Equity	2.0%	31.0%	9.0%	N/A	2.5%
12-Month Revenue Growth	5.6%	5.5%	2.9%	5.8%	5.8%
12-Month Net Income Growth****	29.5%	23.5%	21.1%	32.0%	42.5%

Source: Compiled from Hoover's Online, "Columbia Sportswear Company" and "V.F. Corporation," accessed June 2010, and Patagonia company documents.

*V.F. Corporation owns The North Face, Inc. The North Face has annual sales of $1.2 billion and 749 employees.

**Patagonia's FY 2010 financial results as of April 30, 2010 are unaudited results.

***For Patagonia, data show the operating margin.

****For Patagonia, data show growth in operating margin.

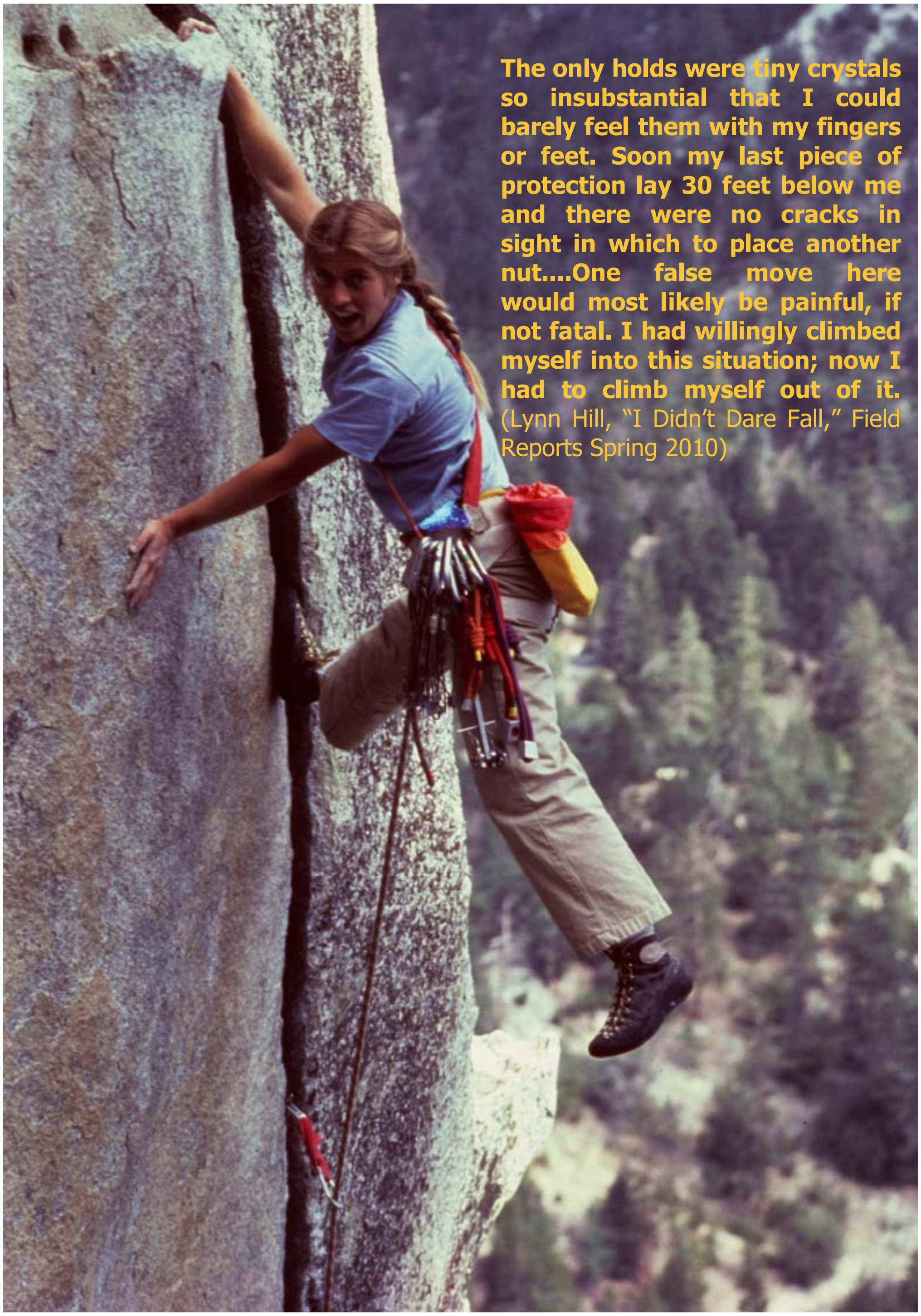
Exhibit 3 Lost Arrow Corporation Balance Sheet

As of FY ended April 30, 2010*	($000)
Assets:	
Cash	$96,118
Accounts Receivable	28,925
Inventory	46,837
Prepaid and Other Current Assets	28,353
Total Current Assets	$200,233
Property Plant & Equipment	$116,403
Net of Accumulated Depreciation	49,660
Other Assets	3,520
Total Assets	$253,413
Liabilities and Equity:	
Current Liabilities	$61,150
Long Term Debt	4,716
Total Liabilities	$65,866
Equity	187,547
Total Liabilities and Equity	$253,413

Source: Patagonia, Inc., internal company documents.

* FY 2010 financial results as of April 30, 2010 are unaudited results.

Exhibit 4 Outdoor Sports Practiced by Patagonia's Ambassadors



Source: Patagonia, Inc., and Field Reports, Patagonia Company Website, accessed June 2010.

Exhibit 5 Lost Arrow Corporation, Sales and Margin by Geographic Market (in $000)

	FY 2002	FY 2003	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010**	2011 BUDGET
Net sales										
North America*	152,772	145,202	158,897	169,192	190,246	198,222	207,447	216,695	229,102	265,765
Europe	24,649	28,467	30,034	29,982	29,205	31,235	33,681	34,165	35,544	35,842
Japan	42,924	45,193	44,451	42,721	42,234	45,960	54,194	62,785	66,796	62,940
South America	-	-	-	-	193	524	756	877	1,420	1,497
Total	*220,345*	*218,861*	*233,381*	*241,896*	*261,878*	*275,941*	*296,079*	*314,522*	*332,862*	*366,044*
Gross margin										
North America*	72,999	73,042	79,900	85,766	90,852	94,535	101,511	104,879	113,745	133,077
Europe	9,441	12,651	13,324	13,077	12,145	12,729	15,085	16,718	17,878	16,023
Japan	22,488	24,585	25,407	24,675	23,750	25,893	30,209	38,200	42,788	36,854
South America	-	-	-	-	93	260	364	401	715	747
Total	*104,929*	*110,278*	*118,631*	*123,518*	*126,839*	*133,417*	*147,169*	*160,198*	*175,125*	*186,700*
Fraction of total sales										
North America*	69%	66%	68%	70%	73%	72%	70%	69%	69%	73%
Europe	11%	13%	13%	12%	11%	11%	11%	11%	11%	10%
Japan	19%	21%	19%	18%	16%	17%	18%	20%	20%	17%
South America	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%
Total	*100%*	*100%*	*100%*	*100%*	*100%*	*100%*	*100%*	*100%*	*100%*	*100%*
Fraction of total gross margin										
North America*	70%	66%	67%	69%	72%	71%	69%	65%	65%	71%
Europe	9%	11%	11%	11%	10%	10%	10%	10%	10%	9%
Japan	21%	22%	21%	20%	19%	19%	21%	24%	24%	20%
South America	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%
Total	*100%*	*100%*	*100%*	*100%*	*100%*	*100%*	*100%*	*100%*	*100%*	*100%*
Change in sales										
North America*	-	-5%	9%	6%	12%	4%	5%	4%	6%	16%
Europe	-	15%	6%	0%	-3%	7%	8%	1%	4%	1%
Japan	-	5%	-2%	-4%	-1%	9%	18%	16%	6%	-6%
South America	-	-	-	-	-	171%	44%	16%	62%	5%
Total	-	*-1%*	*7%*	*4%*	*8%*	*5%*	*7%*	*6%*	*6%*	*10%*
Gross margin / sales										
North America*	48%	50%	50%	51%	48%	48%	49%	48%	50%	50%
Europe	38%	44%	44%	44%	42%	41%	45%	49%	50%	45%
Japan	52%	54%	57%	58%	56%	56%	56%	61%	64%	59%
South America					48%	50%	48%	46%	50%	50%
Total	*48%*	*50%*	*51%*	*51%*	*48%*	*48%*	*50%*	*51%*	*53%*	*51%*

Source: Patagonia, Inc., internal company documents.

* Shows data for the United States and Canada Markets combined.

** Shows data as of June 2010.

Exhibit 6 Example of Patagonia's Catalogs

Source: Patagonia, Inc., "Surf Spring," Online Catalogs, Patagonia Company Website, accessed June 2010.

Exhibit 7 Example of Patagonia's Advertisements

Source: Patagonia, Inc., Advertisement, in Surf Magazine, October 2007.

Exhibit 8 Example of The Footprint Chronicles

Source: Patagonia, Inc., "The Footprint Chronicles: Organic Cotton Jeans," Environmentalism, Patagonia Company Website, accessed June 2010.

Exhibit 9 The Evolution of Patagonia's 1% for the Planet Commitment*

Source: Patagonia, Inc., internal company documents.

*Patagonia's 1% Commitment includes all Grants, Non-Cash, Dues & Charity Matching programs, and administration costs related to environmental causes.

Exhibit 10 Patagonia's Environmental Commitment in FY 2009

	2009
Environmental Grants Program	
Biodiversity	714,618
Forests	248,680
Sustainable Agriculture	143,700
Resource Extraction	281,304
Toxics/Nuclear	89,140
Water/Marine	682,137
Alternative Energy	31,500
Social Activism	291,925
Total	2,483,004
Non-Cash Donations	
Product donations	100,000
Creative Services Projects	11,280
Total	111,280
Company Campaigns	
Catalog spreads	338,000
Ads/placement	28,932
In-store displays	30,741
Retail events	100,000
Initiatives booklet	102,793
World Trout	50,000
Voice Your Choice	92,000
Wild & Scenic Film Festival	50,000
Total	792,466
Other	
1% for the Planet Dues	50,000
Conservation Alliance	110,000
Employee Internship Program	70,000
Employee Charity Match Program	200,000
Total	430,000
TOTAL	3,816,750

Source: Patagonia, Inc., "Environmental Initiatives 2009."

Appendix A[a]

Patagonia's Switch to Organic Cotton

Measuring the Environmental Impact of Cotton Products

In the early 1990s, Patagonia conducted a lifecycle analysis of a cotton T-shirt, measuring the resources (e.g., electricity, water) consumed at each stage in the lifecycle and assessing other environmental impacts (e.g. soil erosion, use of pesticides). Products made from conventionally grown cotton generated various types of environmental harm at each stage. Growing and harvesting cotton consumed large quantities of pesticides and water, dyeing and finishing fabric used toxic chemicals, and consumer maintenance of a garment required energy and water use. Patagonia found that organically grown cotton produced the same environmental impacts in most stages. In the cotton-growing stage, however, it generated a significantly smaller environmental footprint, as organic practices did not use synthetic fertilizer, herbicides, or pesticides. Using principles of activity-based accounting, Patagonia calculated in 1995 that this difference in environmental impact corresponded to a dollar figure of $.33 for every cotton T-shirt.[127]

Deciding to Use Organic Cotton

Due to the smaller environmental cost of organic cotton, Patagonia introduced its first organic cotton in its fall 1992 product line. Although the product failed in the market, Patagonia's Board of Directors voted in 1994 that all conventionally grown cotton be eliminated from Patagonia's cotton products by spring 1996. At risk was around $20 million in sales, or 20% of Patagonia's business.[128] Former VP of Environmental Initiatives Jil Zilligen explained the factors that made Patagonia's switch to 100% organic cotton feasible for the company:

> Going completely to 100% was difficult and a scary thing to do … but it helped knowing that our technical shells and other products would continue to support the company even if we floundered for awhile in organic cotton …. [B]eing privately owned also played a role …. [I]f we were publicly owned we might have had to add a blending program or offer fewer products in the organic cotton line.[129]

Patagonia decided to use "transitional" as well as certified organic cotton. Transitional cotton was grown using organic practices, but on farms that had used organic practices for an insufficient time to be certified organic. Furthermore, in deciding to switch to organic cotton, Patagonia did not commit to making "organic clothing." It continued to use synthetic dyes rather than natural dyes that might not meet Patagonia quality standards, as well as conventional cotton or polycotton thread to sew the garments.[130]

Challenges of Switching to Organic Cotton

Limited availability of fabric Patagonia found at that time that little certified organic cotton was grown both within and outside the United States. Consequently, few of the cotton fabrics that Patagonia used were available in organic versions, decreasing its number of cotton fabrics from 31 in 1995 to 14 in 1996.[131] Between 1995 and 1996, Patagonia had to reduce its line from 91 cotton styles to 66.[132]

[a] This appendix draws heavily from Forest Reinhardt, Ramon Casadesus-Masanell, and Debbie Freier, "Patagonia," HBS Case No. 703-035 (Boston: Harvard Business School Publishing, 2003).

Increased costs Because of the difficulties of growing cotton organically, prices for organic cotton were 50% to 100% higher than for conventional cotton, raising the cost of organic cotton fabric to triple that of conventional cotton fabric.[133] (See **Table A-1** for differences in costs between organic and conventional cotton products.)

Table A-1 Differences in Costs for Products Using Organic vs. Conventionally Grown Cotton

	Conventional Cotton Cost	Organic Cotton Cost
Heavy Flannel Shirt	18.83	23.81
Kid's Heavy Flannel Shirt	12.27	15.42
Zip Front Flannel Shirt	20.51	25.06
Kid's Climbing Pants	13.52	15.48
Baby Cotton Coverall	13.29	16.29
LT WT Stand Up Shorts	12.36	14.11
Mondos Shorts	13.75	15.86
Bombachas	20.05	23.73
Bombachas (Reg)	20.46	24.63
A/C Shorts	12.39	14.67
Women's A/C Civilized Shorts	12.70	16.79
Women's A/C Short Skirt	12.67	15.59
Mondo Pants	17.86	23.23
GI Stand Up Shorts	15.40	19.69

Source: Compiled from Patagonia, Inc. internal company documents.

Changes in supply chain Many of Patagonia's fabric vendors refused to switch to organic cotton, citing a lack of supplier alternatives and skepticism about market potential.[134] Patagonia's staff had to go back to the beginning of the supply chain to identify cotton brokers with access to organic cotton. Of the eight fabric mills that Patagonia used for its supply, only two had previous experience with organic cotton.

Loss in quality Patagonia initially experienced quality problems with some of its organic cotton products, such as shrinkage, pilling, and poor colorfastness. Zilligen hypothesized at the time that these "significant quality issues" were likely a result of the changes in the production process, such as using less harsh finishing techniques, rather than the cotton fiber. She commented, "Again, we are struggling with the intersection of environmental efforts and our rigid demand for top quality.[135]

Marketing and Sales

Patagonia's marketing team's primary goal for its spring 1996 organic cotton line was to sell the line successfully. Patagonia reduced its margins on most cotton products so that a retail price on a particular product would not rise more than 20% over the price of the product with conventionally grown cotton. On average, organic cotton garments sold for 8% more than comparable garments made from conventional cotton.[136]

Inspiring Other Firms

To encourage other apparel firms to use organic rather than conventionally grown cotton, Patagonia organized trips of employees, journalists and representatives from other apparel companies to cotton fields in the Central Valley of California, a once-beautiful landscape turned into "toxic soup."[137] It shared information with other firms on the organic cotton business and encouraged them to switch as well. Former VP of Production Julie Ringler explained, "The goal is to make organic cotton a sustainable business. We're extremely open with anyone that wants to find out more about organic cotton, offering advice to Marks and Spencer and Nike, for example. It goes with our mission statement."[138]

In 1998, Nike debuted apparel containing 3% certified organically grown cotton blended with 97% conventionally grown cotton, producing nearly 4 million T-shirts for fall 1998. By 2009, 86% of Nike's cotton apparel contained a minimum of 5% organic cotton, and more than 14% of all cotton used was organic. It announced that it would strive to blend a minimum of 10% organic cotton in all of its cotton products by 2015.[139]

Throughout the 2000's, global retail sales of organic cotton apparel and home textile products grew at an average annual growth rate of 40%, reaching an estimated $4.3 billion in 2009.[140] 10,731 acres in the United States were planted with organic cotton in 2009, compared to 900 acres in 1990.[141] By 2010, many other apparel companies including H&M were using organic cotton, and retailers like Wal-Mart and Target featured organic cotton garments in their stores.[142]

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