2006

Gap, Inc

MB107 Group 17

[GAP STRATEGIC REVIEW]

An overview of Gap's current problems and suggestions to solve them.

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Apparel Market

1. Global brands that appeal to a wide demographic are becoming difficult to grow.
   - Discount retailers and 'superstores' compete on selling clothing basics to all ages.
   - Apparel and Accessories accounted for 22% of Target's revenue in 2005.
   - Specialty apparel market is segmenting, with brands to serve each market niche.

Gap, Inc

1. Gap, Inc is unable to grow its core brands in the US market.
   - Market saturation and increasing competition make It impossible to grow Gap rapidly enough to please shareholders.
2. Gap, Inc cannot change consumer perception of the clothing its brand sells without extensive change and substantial risk.

Recommendations

Strategic Direction

1. Expand brand portfolio.
   - Create niche or local brands to address market segmentation.

New Initiatives

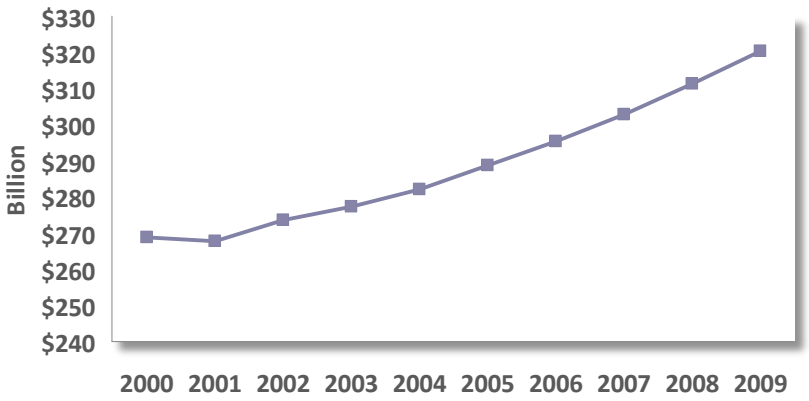
1. Establish a new brand (*Spry*) to operate in the growing Fast Fashion market, with new styles weekly or bi-weekly.
2. Disassociate new brand (*Spry*) from Gap and Old Navy brands.

Background

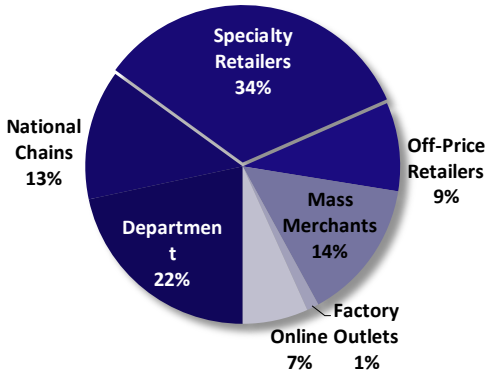
Apparel Industry

The apparel industry is growing at roughly 2% per year, and specialty apparel retail occupies 34%.

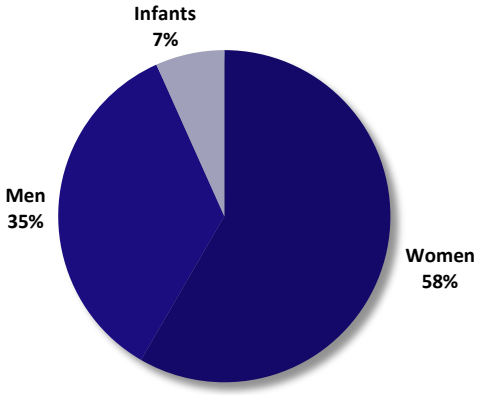
Apparel Industry Growth Projection



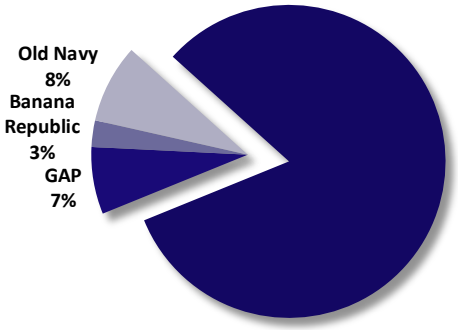
Spending by Channel



Revenue by Gender



Brand Share of Specialty Retailing

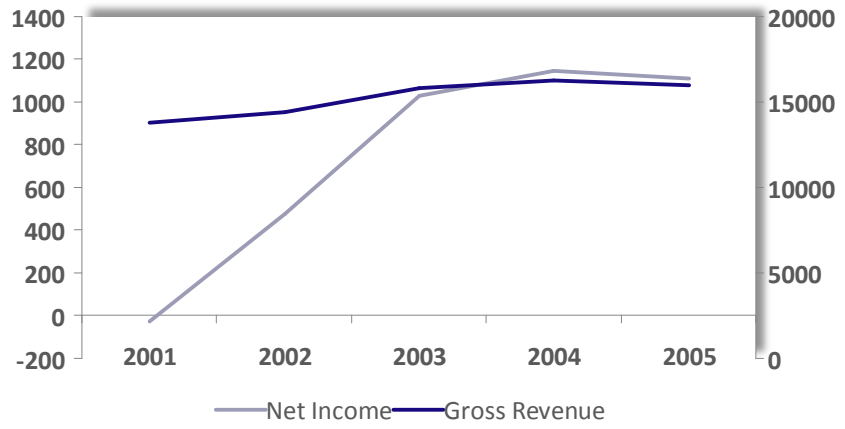


Background

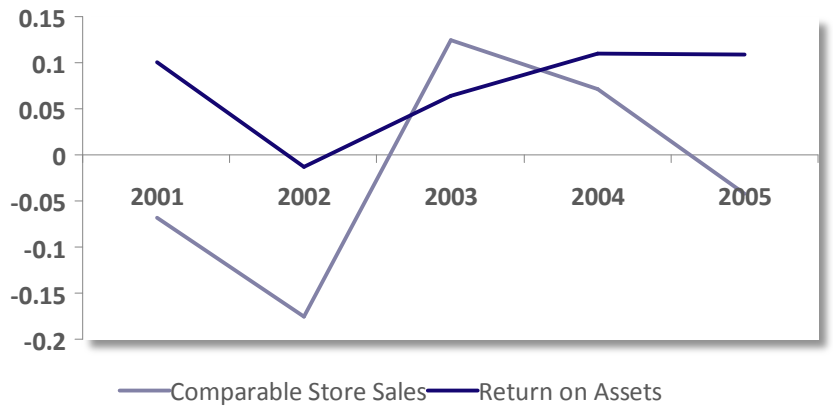
Gap, Inc Performance

Gap, Inc is having trouble expanding its bottom line; revenue and income are fluctuating, while sales per sq. ft fail to grow.

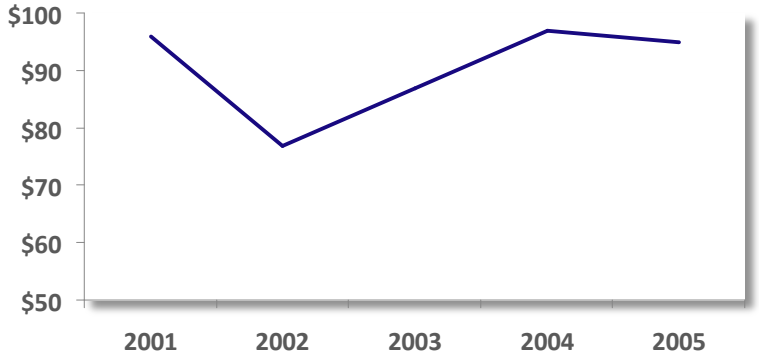
Revenue and Income Performance



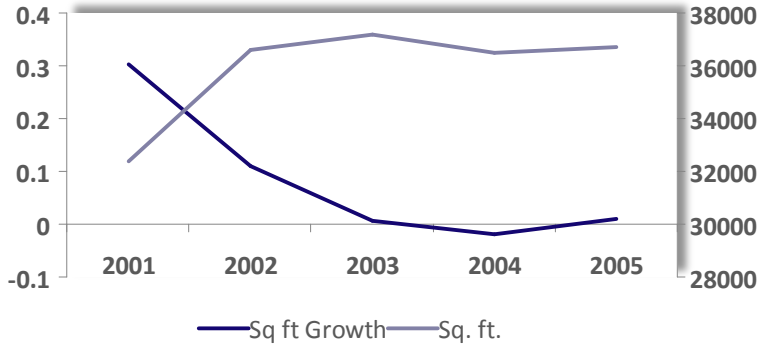
Store Sales and Return on Assets



Sales per sq. ft.



Expansion



Background

Why Fast Fashion?

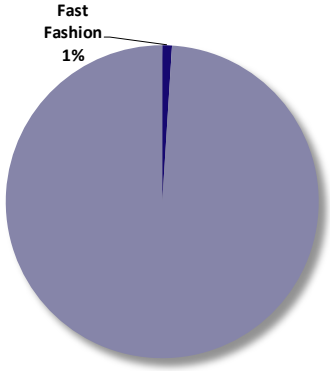
Fast fashion is only 1% of sales in the USA, compared with between 5% and 17% in Europe. Volume is expected to grow over the next five years to 6% in the USA. Additionally, fast fashion retailers have been growing stores and profit in double digits.

Overview

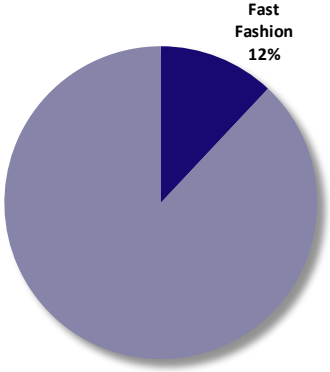
1. The fast fashion has been a rapidly growing market segment in Europe, growing at 3 times the overall apparel industry. This growth has barely begun in the USA, with global fast fashion retailers having only a handful of stores divided across the major cities.
2. Gap, Inc has the opportunity as a US-centric company to establish a fast fashion division and dominate the US fast fashion market. Domestic competition exists, but doesn't have the economies of scale, resources, or infrastructure Gap, Inc does.

H&M

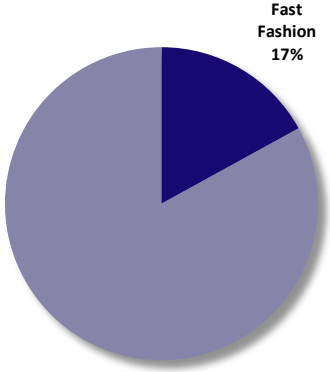
USA



UK



Spain



Spry

Brand

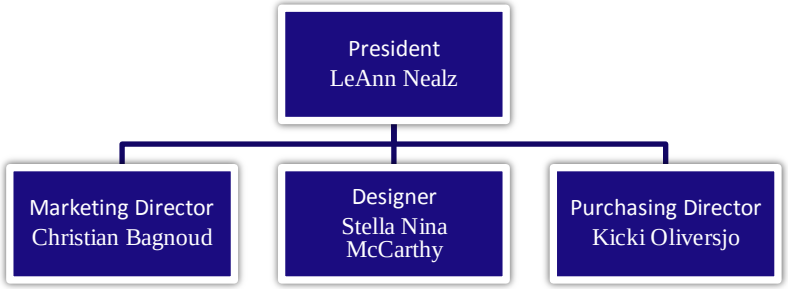
Spry is a new, young, edgy brand in the fast-fashion segment of the apparel industry.

Image

1. Spry is a youthful, edgy brand full of energy.
   - Modern, colorful clothing and store layout.
   - A vibrant, well-illuminated store, with a touch of urgency. As fast fashion clothing is created in limited-run batches, the customer should feel that urgency is imperative.
2. Focus on selling the goods
   - Spry should be a destination, where teenagers compete to wear the latest fashions.
   - Urgency and snap-decision making are imperative.

Logo

Corporate Structure



President LeAnn Nealz

LeAnn Nealz is the Executive Vice-President and Chief Design Officer of American Eagle Outfitters, a specialty apparel retailer selling clothing to 15-25 year olds; the same demographic Spry is serving.

Marketing Director Christian Bagnoud

Christian Bagnoud has been the H&M Director of Marketing in Canada for the last 13 years.

Designer Stella Nina McCarthy

Stella McCarthy is a high-end fashion designer with experience designing for H&M, Gucci, and Addidas.

Purchasing Director Kicki Oliversjo

Kicki Oliversjo is currently the Director of Purchasing at Lindex; has worked as a fashion and textile consultant, and has 12 years experience at H&M as a section manager.

Spry

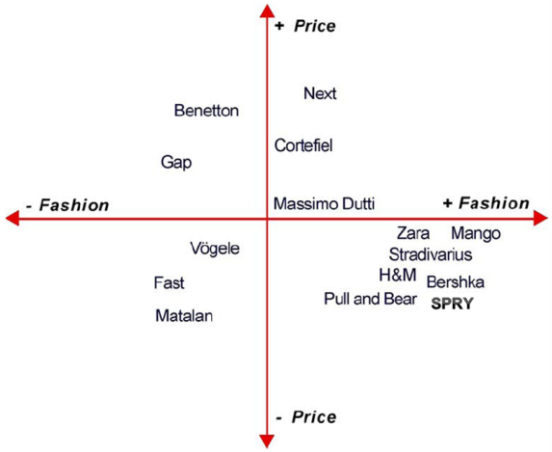
Positioning

Price Point

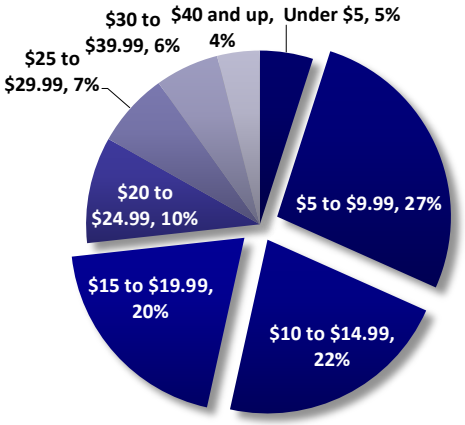
- Spry clothing will be priced at an affordable level, with core goods going between $10 and $40.

Clothing Category	Price Range
Accessories	$1.00 - $15.00
Fleeces	$15.00 - $25.00
Jackets	$40.00 - $60.00
Jeans	$15.00 - $25.00
Shirts	$8.00 - $20.00
Skirts	$12.00 - $20.00
Sweaters	$15.00 - $20.00
Underwear	$3.00 - $12.00

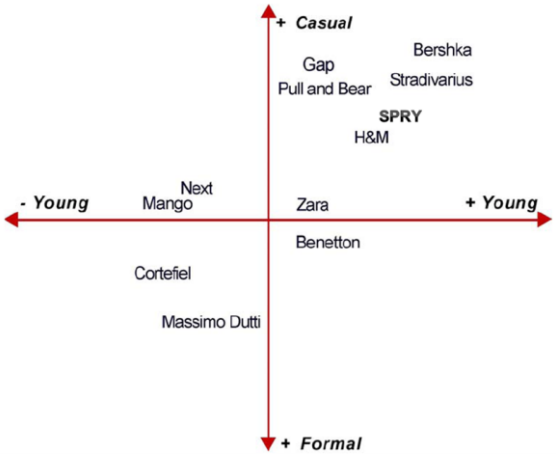
Price vs. Fashion



Volume by Price Point



Formal vs. Age



Spry

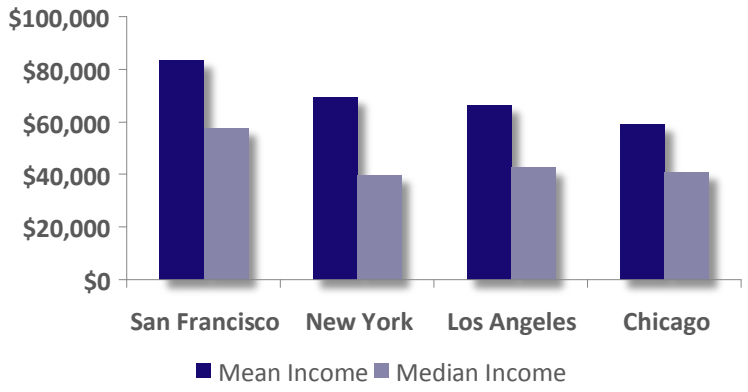
Locations

We intend to launch in San Francisco, after comparing the demographic information for potential cities from the US Census.

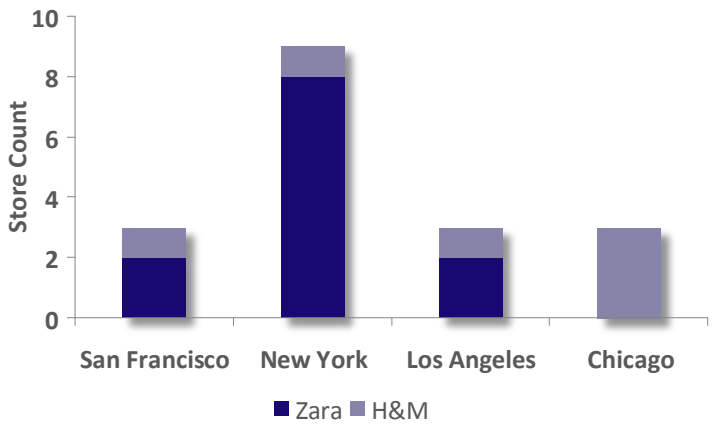
Store Details

1. Spry will launch in 10,000 sq. ft., consistent with Gap, Inc's other stores and the apparel industry.
2. Stores will have an edgy atmosphere, with popular music varying by store region; initially leveraging the radio. Customer should feel welcomed at a part of the brand identity.
3. Store will be brightly lit, emphasizing minimalistic store design focused on revealing the clothing.
4. Winding path divides men's clothing from women's clothing, leading to the cash register at the back of the store.

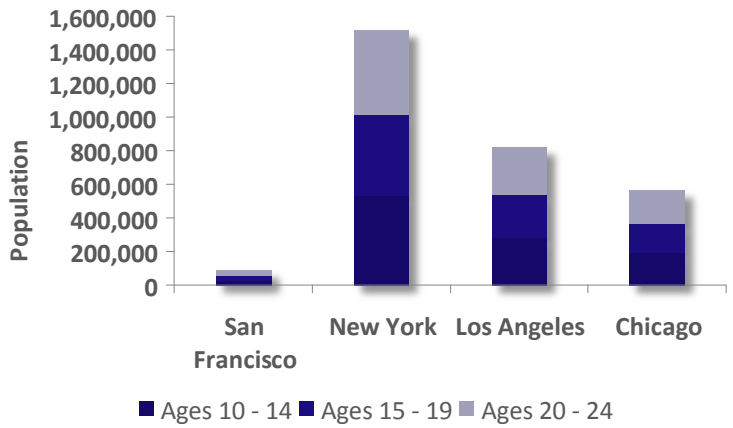
Household Income for Preferred Cities



Competition



Population of Basic Demographic



Spry

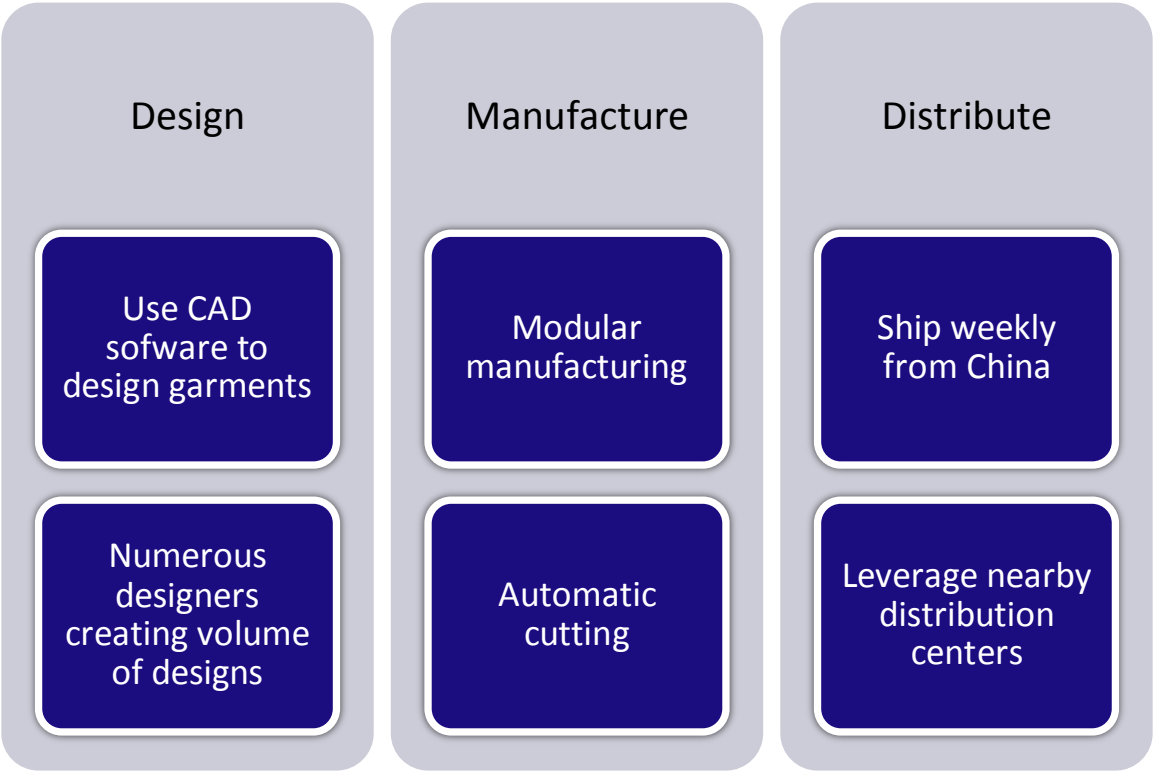
Supply Chain

Spry cannot use Gap, Inc's existing supply chain without change, as fast fashion cycles much more quickly. However, Spry can leverage Gap, Inc's relationship with suppliers and distribution network.

Overview

- High use of technology in the supply chain leading to high supply visibility and responsiveness to demand and changing trends.
- Rapid adaptation of designs from existing trends and popular designs into clothing.
- Ship frequently in small quantities and deliver to stores with minimal storage.

Fast Fashion Process



Spry

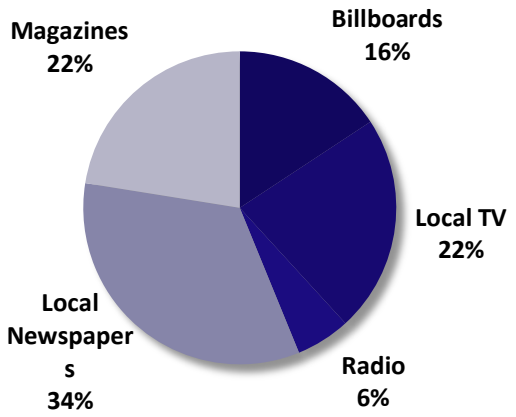
Marketing

Spry will emphasize local, easy-to-connect to advertising. Customer satisfaction should be the primary growth avenue, with marketing creating brand awareness and identity.

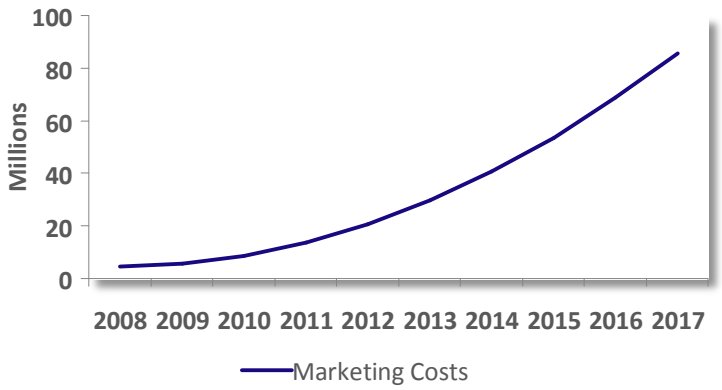
Marketing Campaign

1. Spry advertising will inspire people to consider clothing as a disposable consumable, not an investment.
2. Advertising will primarily be local, focusing on generating grass-roots support for the brand. Marketing will attempt to establish a "pull" expansion strategy for Spry, generating local support and excitement for the clothing instead of pushing the store everywhere.
3. Marketing will involve identifying best customers through the IT system and rewarding them with in-store parties, fashion exclusives, and ability to order clothing before anyone else.

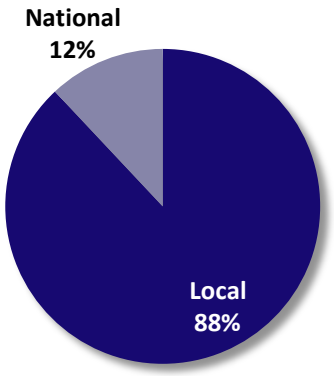
Marketing Spend by Channel



Marketing Cost Projection by Year



National vs. Local Spending



Spry

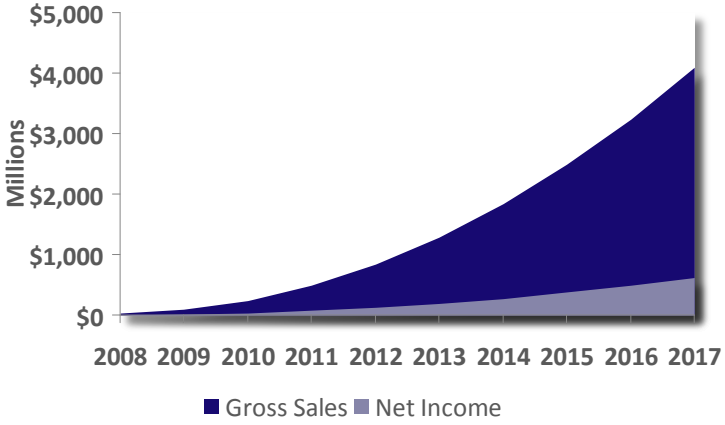
Expansion

Overview

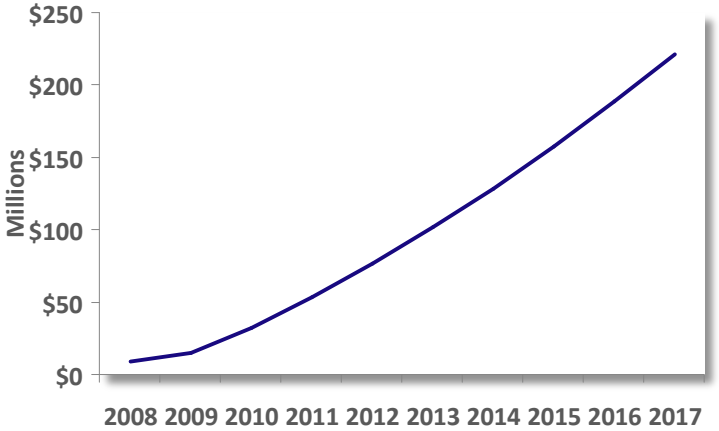
1. Spry will establish itself in major cities nationwide to test interest in various locations, before beginning a national expansion policy to place a store in every town.
2. Revenue will grow per store; we expect revenue per store to be a conservative $5 million.
3. Spry will push the concept of disposable fashion, which requires Spry stores to be in fairly high-traffic areas. Existing Gap, Inc stores that are underperforming can be replaced by Spry stores.

Store Growth

Income from Spry



Expansion Costs



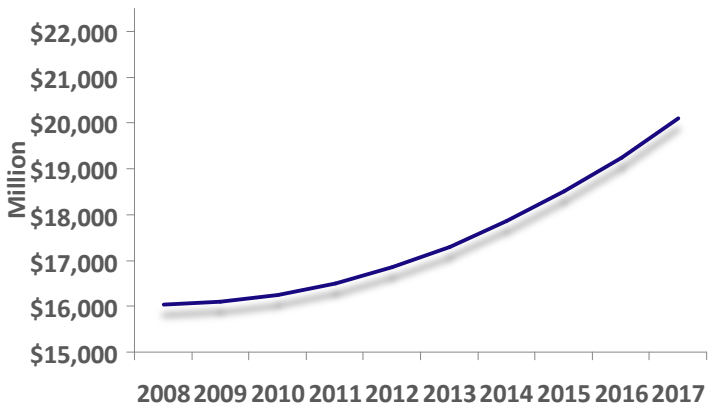
Spry

Results

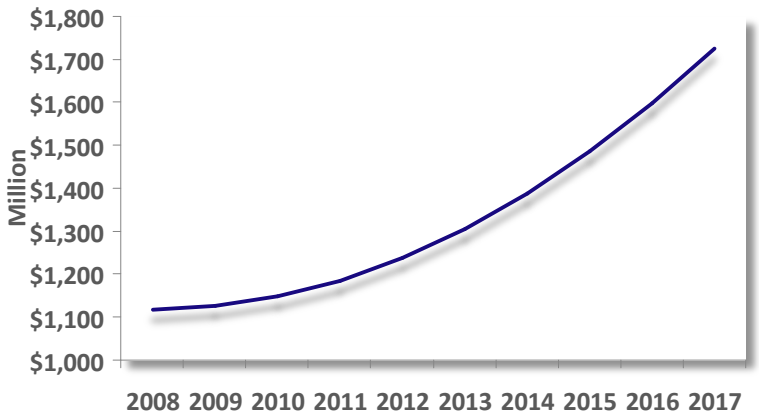
Results Forecast

Year	Stores Opening	Total Stores	Store Expansion	Marketing Cost	Expansion Cost	Rent	Total Sq Ft	Gross Sales	Net Income
2008	6	6	$4.8	$4.6	$9.4	$6	60,000	$30	$4.5
2009	12	18	$9.6	$5.8	$15.4	$18	180,000	$90	$13.5
2010	30	48	$24.0	$8.8	$32.8	$48	480,000	$240	$36.0
2011	50	98	$40.0	$13.8	$53.8	$98	980,000	$490	$73.5
2012	70	168	$56.0	$20.8	$76.8	$168	1,680,000	$840	$126.0
2013	90	258	$72.0	$29.8	$101.8	$258	2,580,000	$1,290	$193.5
2014	110	368	$88.0	$40.8	$128.8	$368	3,680,000	$1,840	$276.0
2015	130	498	$104.0	$53.8	$157.8	$498	4,980,000	$2,490	$373.5
2016	150	648	$120.0	$68.8	$188.8	$648	6,480,000	$3,240	$486.0
2017	170	818	$136.0	$85.8	$221.8	$818	8,180,000	$4,090	$613.5

Impact on Gap, Inc Sales



Impact on Gap, Inc Income



Spry

Risk Assessment

Market Risks

1. Fast fashion does not appeal to the US market, failing to grow far beyond 1%.
2. US economy experiences a recession.
3. Further reduction in consumer spending in the 15-25 age bracket due to increasing volume of "must haves," such as gadgets; iPod, accessories, laptop, cell-phone, etc.
4. WTO or US government introduce trade quotas, forcing Spry to find and train new suppliers in different countries.

Initiative Risks

1. Existing supply chain cannot easily be modified to support fast fashion; technology implemented does not integrate with Oracle/Retek IT system.
   - Suppliers can be trained, but early missteps could be critical to destroying the brand.
   - Technology required is off the shelf, and there should be no problem with existing supply chain.
2. Staff hired fail to grasp key fast fashion elements and, under pressure from Gap, Inc to show fast results, clone existing Gap, Inc supply system with differentiating well from Old Navy.
3. Fashion director misjudges styles required in fast fashion, or fails to use required technology.
4. Overexpansion stretches Gap, Inc's resources and grows beyond demand; duplicating Gap, Inc's mistakes in 2000.

SWOT Analysis[1]

Conclusions

Gap, Inc has a strong brand portfolio and stable revenues. However, it is beset by problems both direct and indirect; structural problems left over from its overexpansion in the late 1990s have made it difficult for Gap to overcome its supply and design problems. Increasing competition on all sides is the major problem facing Gap, and one it is having difficulty solving.

Strengths	Weaknesses
■ Brand recognition ■ Strong online presence	■ Relatively less differentiated fashion collection ■ Geographically concentrated operations ■ Seasonal pattern of business ■ Fluctuating sales per sq. foot ■ Geographically fragmented manufacturing
Opportunities	**Threats**
■ Launch of Forth and Towne ■ Elimination of textile quotas ■ Customer database and smart cards ■ Fast fashion	■ Industry consolidation ■ Reduction in US consumer spending ■ Threat from counterfeit products ■ Increasing segmentation of apparel market by brand

Strengths

Brand recognition

The company's Gap, Banana Republic and Old Navy brands are among its most important assets. These brands are one of the most widely recognized brand names within the retail apparel industry. They have a significant degree of credibility and presence in the marketplace. This provides the brand with a distinct competitive advantage.

Strong online presence

The role of the Internet has been a major growth driver for the company. Gap operates three websites for tapping on this opportunity - gap.com; bananarepublic.com; and oldnavy.com that offer the respective brands. Websites provide a virtual showcase for companies, giving

[1] SWOT Analysis adapted from 2005 Datamonitor SWOT

customers the ability to shop for merchandise, whilst allowing them to see and experience the brand. In light of rising online sales, a strong web presence has given the company a competitive edge within the market.

Weaknesses

Relatively less differentiated fashion collection

Basic apparel items tend to be commodity-like, and thus differentiation comes mainly through price, with lower priced competitors usually winning market share. The current price-driven sales environment places the company at a disadvantage. In an environment where basic wardrobe product offerings are indistinguishable from one specialty retailer to the next, and the shopping decision is made on price, Gap is likely to lose its customers to lower priced discount retailers. Moreover, the more fashion-conscious customers would be willing to buy from other supply chain leading stores that offer exclusive fashion garments such as H&M, Target and Zara. The company's competitors have become much quicker in getting in new fashions, increasing competition and putting Gap at a comparative disadvantage.

Geographically concentrated operations

The company relies heavily on the North American markets for its revenue generation. In fiscal year 2005, the North American market alone accounted for 90.7% of the company's total revenues. The remaining segments Europe and Asia contributed merely 5.4% and 3.6% respectively in fiscal 2005. Such a heavy reliance on this market exposes the company to market concentration risks.

Seasonal pattern of business

The company's business follows a seasonal pattern, with sales peaking over a total of about 13 weeks during the Back-to-School (August) and Holiday (November-December) periods. During fiscal year 2004, these periods accounted for approximately 32% of the company's net sales. This generates weakness in the business activities at other time periods and adversely affects the results of operations.

Fluctuating sales per sq. ft.

Gap, Inc sales per sq. ft. have fluctuated between $100 and $60 per sq. ft. While Gap, Inc recovered to reach $95 per sq. ft. in 2004 and 2005, 2006 sales have again dropped. Gap, Inc needs to show consistent growth in sales per sq. ft.

Geographically fragmented manufacturing

Gap, Inc uses a multitude of geographically fragmented manufacturers for its clothing, a remnant of the Multi-Fiber Agreement Treaties. This increases costs across the company.

Opportunities

Launch of Forth and Towne

Gap launched Forth and Towne brand, the company's new women's apparel retail in April 2005. The new brand focuses on women over age 35 and would offer a broad range of sizes, with a focus on fit, and assortments that serve a variety of occasions. A rapidly growing segment of the population, this group's spending power accounts for about 39% of women's total apparel expenditures. Forth and Towne will launch in four test stores in the Chicago market and one in New York in fall of 2005. This represents an important long-term growth opportunity for the company.

Elimination of textile quotas

The elimination of textile quotas offers immense growth opportunities to retail apparel companies such as Gap. Under the terms of the World Trade Organization's (WTO) Agreement on Textiles and Clothing, US quotas on imports of textiles and apparel from most WTO members were lifted in January 2005. This will enable US retailers to procure high quality merchandise at a low cost, whilst providing the opportunity to broaden their product portfolios. This event would improve flexibility in obtaining imported merchandise manufactured in WTO countries. Since Gap sources its merchandise from more than 700 vendors in 50 countries, such an agreement may provide ample savings opportunities to the company.

Customer database and smart cards

Understanding customer's needs and preferences has become a critical element in the retail sector. Compilation of customer information, covering preferences, tastes and spending patterns, has enabled retailers to alter their product display and maintain inventory accordingly. Rising usage of smart cards can also benefit discounters and department store operators in improving their customer service and managing their inventory effectively.

Fast Fashion

The fast fashion industry has become a significant part of the European apparel market, and growth is set to accelerate in the USA. Fast fashion growth will primarily come from specialty apparel retailers targeting the teenage crowd, as well as discount stores who are unable to duplicate the supply chain responsiveness. The market segment is young enough for Gap to become a primary player in the segment by leveraging its economies of scale and experience in the retailing industry.

Threats

Industry consolidation

Merger and acquisition activity has been rife amongst US discounters and department stores, creating larger entities with huge scale economies, whose superior bargaining power with suppliers are fueling higher margins within the US retail environment. Carter's acquired Oshkosh B'Gosh in 2005 while New York & Company acquired Boston based Jasmine Company, a privately held women's retailer of upscale and contemporary apparel, footwear and accessories under the JasmineSola and Luisa Luisa brand names. Greater consolidation in the industry would lead to higher competition levels and thereby lower the profit margins for the company in future.

Reduction in US consumer spending

The downturn of the US economy since 2001 has adversely affected the purchases of discretionary luxury items, adversely affecting sales of major apparel retailers. Many factors that affect the level of consumer spending in the apparel and accessories industry include general business conditions, interest rates, and the availability of consumer credit, taxation and consumer confidence in future economic conditions. Apparel retail forecasts for 2005 show a slow growth of 3.8%, even lower than 5.2% in 2004. Consumer purchases tend to reduce during recessionary periods and retail stores like Gap may face a decline in demand of their offerings and thereby a fall in its revenues.

Threat from counterfeit products

Estimated counterfeit sales of around $500 billion per year are a major problem for companies within the apparel and accessories markets. The increasing penetration of counterfeit products can lead to a negative impact on company sales and as a result of this, companies have been working in tandem with government officials to target this threat. However, investments and commitment required in successfully countering the threat from counterfeit products is huge. Therefore until the industry sees significant progress on this front, apparel retailers such as Gap would continue to witness erosion of market share and dilution of brand equity.

Increasing segmentation of apparel market by brand

The apparel market is becoming increasingly segmented by brand, with niche brands catering the specific tastes. This "cherry picking" of profitable consumers is likely to increase, as large companies create diverse brand portfolios to both minimize risk and increase appeal to target demographics.

Strategy Diamond

Conclusions

The Strategy Diamond reveals that Gap, Inc is primarily continuing to turn a profit through its strong brand image; it doesn't have any substantial differentiators that allow it to challenge discount retailers or increasingly niche-targeted brands.

Economic Logic	Arenas	Vehicles	Differentiators	Staging
■ Consistent sales with reliable inventory and strong brand identity	■ Discrete stores locations selling apparel, segmented by brand identity ■ Strong online presence selling directly to consumer ■ Target demographic varies by brand ■ Domestic dependence, international growth in Japan, UK	■ Construction of new stores ■ Establishment of new brands ■ Reducing supply chain fragmentation	■ Brand identity ■ Custom IT solution by Oracle and Retek	■ Create new brands to expand into new demographics ■ Increase presence online ■ Establishing stronger supplier relationships ■ Customer tracking system

PESTEL Analysis

Conclusions

Gap, Inc has a stable political and legal situation. However, changes in the overall economy are increasing prices while consumers are becoming less enchanted with clothing, and Gap's staple clothing in particular.

Political	Economic	Socio-Cultural	Technological	Environmental	Legal
Elimination of MFA quotas allows reduction in prices.	Increase in real estate prices in prime locations will slow store expansion and may require reduction in floor space.	Increase in individual fashion raises required product diversity.	Increasing use of technology lowers supply chain costs.	Global warming may lead to increased demand for summer-wear.	Legal concerns over copyrighted designs in fashion world.
Stable domestic political situation.	Oil prices raise costs through the supply chain.	Ongoing aging of Baby Boomer population implies new, older and affluent market.	Ubiquitous internet access implies new avenue for direct sales.	Factories with better environmenta l standards.	Potential problems with business methods patents in supply chains.
	Decreased spending on clothes as proportion of income reduces potential market.	Trend towards professional appearing garb.	Internet access allows greater price comparison by consumers.		
	Decreased overall leisure spending shrinks market for high-margin fashion products.		Increase in communication and celebrity gazing decreases fashion shelf life, increases demand for cutting edge fashion.		

Michael Porter's 5 Forces

Conclusions

The specialty apparel industry is facing increasing competition and market segmentation, while costs to expand remain high.

Barriers to Entry	Threat of Substitutes	Supplier Power	Rivalry	Buyer Power
High capital expense to establish strong retail presence	None.	Large number of suppliers leads to low prices	Discount retailers also sell clothing, reducing margins of specialty apparel retailers	Rapidly changing fashion desires for core demographics leads buyers to trendy brands
Entrenched brand identity		Difficulty of training Eastern suppliers leads to exclusive relationships and a reduced volume of good suppliers	Move to mimic high fashion in short time over staple clothing	
Switching costs away from brand identity			Competition over brand image instead of prices	
Access to good suppliers				