

Gap, Inc.: Has the Retailer Lost Its Style?



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Used by permission. The authors would like to thank Professors Robert E. White and Robert E. Hoskisson for their support and under whose direction the case was developed. The authors do not intend to illustrate either effective or ineffective handling of a managerial situation. The case solely provides material for class discussion.

Introduction

“Alongside some of the most talented people in the apparel industry, we’ll work to reestablish each brand’s leadership position and set the company along a path of sustained earnings performance,” said Glenn Murphy, Chairman and Chief Executive Officer, Gap, Inc.

In July 2007, Gap, Inc. announced the appointment of Glenn Murphy to serve as chairman and CEO. This appointment came after an arduous seven-month search to fill the vacancy of deposed former CEO Paul Pressler. The once-iconic American brand suffered as customers defected to merchants that offered more hip choices, lower prices, or both. In 2007, after more than four years under Pressler’s leadership, Gap, Inc.’s position in the marketplace could only be deemed weaker. By the fall of 2010, Gap, Inc. had experienced five consecutive years of decreasing sales, failed turnaround attempts, and fashion mistakes. CEO Murphy continues to lead Gap’s efforts to reverse this trend in a hostile retail environment during an economic downturn and to regain its merchandising edge.¹

From a financial stability perspective, Pressler left the company in better shape than when he assumed control in 2003 from his embattled, yet highly popular, predecessor, Mickey Drexler. In the last two years of Drexler’s regime, Gap, Inc.’s stock fell by two-thirds and the firm was having difficulty dealing with the realities of \$3.4 billion

of debt. The two former CEOs could not have been more different. Drexler possessed the fashion instincts that built the Gap brand and image into a destination for multiple target customer groups. However, his style lacked the financial rigor and discipline that a company the size of Gap, Inc. requires. Although this played to the strength of Pressler, he was not able to balance the discipline of running a multi-tiered global operation with the artistry required to be successful in the highly fickle retail environment.

When Glenn Murphy embarked on this challenge, he was faced with the daunting task of charting a course back to market competitiveness, a task that has not yet been fully accomplished during the economic downturn. Under Murphy, Gap reduced its U.S. store count while expanding slowly and cautiously in Europe and Asia, made the revamping of its Gap brand women’s apparel collection a top priority, replaced the Gap brand chief designer and redesigned its plain stores with a warmer more homey atmosphere.² The question is whether these steps will be enough, or if more drastic measures will be required. Understanding the history of Gap, Inc. can help provide an answer.

History

Early History

The first Gap store was founded by Don Fisher, a wealthy California real estate developer, and his wife Doris in 1969. Noticing the increasing popularity of jeans and enlightened by his inability to find jeans that fit in a department store, Don decided to open his own retail store. He chose the catchy name “The Gap” referring to the Generation Gap between the Boomers and the previous Silent Generation. At the time of its founding, the store supplied a single product, Levi Strauss jeans.³

Gap was an immediate success, and only two years later it was a publicly traded company. With 186 stores and sales worth \$100 million in 1975, the company found success with its new “fall into the Gap” campaign, which targeted the 14- to 25-year-old market by establishing small, brightly painted stores where rock music was played. Gap experienced phenomenal sales growth over the next several years, reaching \$307 million in 1980. (A timeline in **Exhibit 1** shows the growth of Gap and its international and brand expansion.) This

success was partly due to Levi Strauss’s advertising, but was also strongly tied to the adherence of important retail rules such as selling a line until it stops selling, rapidly replenishing inventory, and maintaining small lines of products in nearly every size and color thus exceeding customer expectations.⁴

However, five years after the initial public offering, the stock fell by nearly two-thirds. The Fishers sold their shares prior to this drastic stock price drop. This action created legal problems for the company when investors launched nine class action

Exhibit 1 Gap Timeline

Key Dates

- 1969:** Don and Doris Fisher open their first store in San Francisco, California.
- 1970:** Gap opens second store in San Jose, California.
- 1971:** Gap Sales at \$2.5 million and incorporates.
- 1972:** Gap has 25 stores and entered East Coast market in New Jersey.
- 1973:** Gap introduces its own labels and sells other brands to diversify from solely selling Levis.
- 1974:** “Fall into the Gap” campaign starts.
- 1975:** Sales at \$100 million 186 stores in 21 states.
- 1976:** Fisher’s releases first large offering of 1.2 million shares to the public at \$18; industry crashes shortly after and stock drops to \$7.
- 1977:** Gap Charitable foundation established.
- 1979:** Gap settles IPO suits for \$5.8 million after selling 10% of holdings before stock crash from \$18 to \$7.25.
- 1980:** Gap sales at \$307 million.
- 1983:** Drexler named president and COO of Gap; Gap acquires Banana Republic.
- 1986:** First GapKids store opens.
- 1987:** First international store opens in London; sales reach \$1 billion.
- 1990:** BabyGap is launched.
- 1992:** Gap becomes second-largest selling apparel brand in the world.
- 1993:** Gap expands to Paris.
- 1994:** Gap Outlet stores open; Old Navy opens first store.
- 1995:** Drexler named CEO of Gap.
- 1996:** Gap expands to Tokyo.
- 1997:** Gap.com Web site comes online; Gap wins marketer of the year award; Old Navy reaches \$1 billion in sales.
- 1998:** Gap opens first location in Alaska.
- 1999:** Banana Republic.com launches.
- 2000:** OldNavy.com launches; Gap launches maternity collection on Gap.com.
- 2001:** Old Navy debuts in Canada; Banana Republic launches petite sizes online.
- 2002:** Pressler named CEO after Drexler retires.
- 2003:** Founder Fisher steps down as chairman of the board.
- 2004:** Bob Fisher named chairman of the board; Gap releases its first social responsibility report.
- 2005:** Gap relaunches Gap.com, Banana Republic.com, and Old Navy.com; Banana Republic opens first store in Japan.
- 2006:** Gap launches online-only shoe line, Piperlime; Gap opens first Gap and Banana Republic stores in Middle East and Southeast Asia; Gap franchise stores open in Malaysia, Singapore, and United Arab Emirates.

(Continued)

Exhibit 1 (Continued)**Key Dates**

- 2007:** Paul Pressler steps down, and Bob Fisher assumes the role of Interim Chief Executive Officer; Glenn Murphy joins the company as Board of Directors Chairman and Chief Executive Officer; Gap franchise stores open in United Arab Emirates, Bahrain, Indonesia, Kuwait, Qatar, Korea, Oman, Turkey, Philippines, Riyadh, and Saudi Arabia; the first Banana Republic franchise store opens in Bahrain, followed by stores in Indonesia, Kuwait, UAE, Malaysia, Singapore, Korea, and Oman; Gap Inc. issues third social responsibility report; Banana Republic franchise stores open in new countries Bahrain, Indonesia, Korea, Kuwait, Malaysia, Oman, Qatar, Singapore, and United Arab Emirates.
- 2008:** The first U.K. Banana Republic store opens in London; Gap Inc. acquires women's active wear company Athleta; Gap Inc. opens 100th franchise store; Gap franchise stores open in Greece and Russia; Banana Republic franchise stores open in Philippines, Saudi Arabia, and Turkey; Gap Inc. launches new online feature offering customers ability to shop all brands with one shopping bag, one easy check-out and one shipping fee; Gap Inc. expands Outlet business with first Gap Outlet and Banana Republic Factory stores in Canada.
- 2009:** Gap franchise stores open in Israel, Jordan, Mexico, and Romania; Gap Inc. issues fourth social responsibility report and for first time in online-only format; Piperlime launches apparel on-site; Gap Inc. co-founder, Chairman Emeritus, and Board Member Donald Fisher dies at age 81.

Source: 2007, Answers.com, Hoover profile: The Gap, www.answers.com/topic/the-gap-inc?cat=biz-fin; 2006, Gap Inc. Issues Statement on Media Reports on Child Labor, www.gapinc.com/public/; 2007, Milestones, Gap Inc., www.gapinc.com/public/About/abt_milestones.shtml, 2010.

suits over alleged insider trading. The suits were settled in 1979 for almost \$6 million dollars.⁵ Luckily this setback was not detrimental, as the company was able to continue to grow by opening a store in New Jersey, selling private label merchandise, and acquiring the apparel company Banana Republic in 1983. As illustrated in **Exhibit 1**, the company continued to execute an expansion strategy after the purchase of Banana Republic, starting GapKids in 1986 and expanding internationally to London in 1987. In 1990, BabyGap was launched and the company's brand value increased rapidly. In 1992 it was the second-largest selling apparel brand worldwide, behind Levi Strauss.⁶

Gap, Inc. continued expansion through the 1990s by establishing Gap Outlet Stores and opening the first Old Navy store in Colma, California, in February 1994.⁷ Old Navy provided some product diversification for the company as the clothing line was less expensive and of slightly lower quality compared to the firm's other offerings. Additional international stores were opened in Paris (1993) and Tokyo (1996). Gap, Inc. was also quick to recognize the value of Internet retailing and debuted its Gap.com website in 1997, bringing Banana Republic, Old Navy, and the flagship brand all online by 2000.

Recent History

In 2006, Gap, Inc. started Piperlime, an online-only shoe store. Gap acquired Athleta, a direct mar-

keter of women's activewear, in October 2008. The acquisition cost of approximately \$150 million was another move toward diversifying its brand offerings. Gap closed 119 stores in 2008 and opened 101 new stores.⁸

In the fall of 2007, media outlets began reporting that Gap, Inc. suppliers were again violating child labor laws. This violation of child labor standards included the manufacture of certain articles sold in GapKids from a supplier in India; a similar violation occurred in 2000 at a factory in Cambodia. After the child labor issues were exposed in Cambodia in 2000, Gap, Inc. began new initiatives concerning child labor, including the annual release of a social responsibility report, beginning in 2003, and the establishment of its social responsibility website at www.gapinc.com/socialresponsibility. As stated on the website, "At Gap Inc., social responsibility is fundamental to how we do business. It means everything from ensuring that workers are treated fairly to addressing our environmental impact." The report describes the company's worldwide efforts to improve factory conditions and help women advance, design more sustainable stores and products, and protect natural resources.⁹

In the third quarter of fiscal year 2010, Gap, Inc. was faced with a mature U.S. market and cautious consumer spending. As a result, Gap chose to focus on finding more sales online and outside. It expanded its online services by launching sites in Canada and

the United Kingdom. It also increased international shipping to more than 80 countries. The first Gap store opened in Shanghai at the same time the online site was launched in China, and the first Gap flagship store opened in Milan, Italy. There were plans to open three more stores in China and an additional Gap store in Rome in 2011.¹⁰ Expansion into South America was also planned for 2011. In November 2010 Gap, Inc. announced a franchise agreement with Komax that would introduce the Gap brand to South America, with the first store expected to open in Santiago, Chile in the Parque Arauco mall in September 2011.¹¹

By fall 2010 Gap, Inc. had approximately 3,100 stores with fiscal revenue of \$14.2 billion¹² and described its business as “a leading international specialty retailer offering clothing, accessories, and personal care products for men, women, children and babies under the Gap, Banana Republic, Old Navy, Piperlime, and Athleta brand names.”¹³ The Gap brand included Gap, GapKids, and babyGap. Gap Outlet and Banana Republic Factory Outlet Stores were also operated by the company. Gap, Inc.’s market capitalization of \$12,743 million was more than four times those of two of its closest competitors, American Eagle Outfitters, with \$3,221 million and J.Crew with \$2,400 million.¹⁴ A list of current and divested Gap, Inc. Brands is illustrated in Exhibit 2.

In addition to past struggles with social issues, the company has experienced significant turnover among its strategic leaders, including the CEO

and the presidents of The Gap and Banana Republic brands.

Leadership Background

The company’s founder, Donald Fisher, served as CEO from 1969 until 1995, when he transitioned to only sitting as chair of the board. Although largely removed from daily operations of the corporation, the founding Fisher family is still a part of the organization, holding multiple positions on the company’s board and maintaining a significant ownership stake in the company. Fisher remained on the board even after stepping down as chairman in 2004, when he was replaced by his son Robert Fisher. Robert Fisher has held numerous senior executive positions within the company and continues to serve on the company’s board. Don Fisher died in September 2009, at age 81.¹⁵

During his tenure as CEO, Don Fisher brought in Mickey Drexler as president in 1983, and selected him as his successor in 1995. Drexler led the company through several successful campaigns in the late 1990s, but sales declined and in 2001, Gap, Inc. posted a significant \$7.7 million loss, shortly after which Drexler retired in 2002. Fisher, still chairman of the board, then recruited Paul Pressler from Walt Disney to help reinvigorate Gap, Inc.’s brand and reputation.

Pressler’s expertise in operational and financial efficiencies did carry over to Gap, Inc., greatly improving the company’s financial standing.

Exhibit 2 Gap Inc. Brands

Current

Gap

Gap Outlet
GapKids
babyGap
GapBody
GapMaternity

Athleta

Old Navy

Banana Republic

Banana Republic Factory Store

Piperlime

Discontinued

Forth & Towne
Gap Warehouse
Old Navy Outlet (converted to Old Navy 10/07)
Hemisphere
Pants %ff
Pottery Barn (sold to Williams-Sonoma)
SuperGap
Tagg’s
You & You

However his lack of experience in the retail apparel industry led to uninspired product development and did little to improve the brand name. Pressler served from 2002 to 2007, resigning after two years of declining sales. Before Gap, Inc. even announced Pressler's resignation, many analysts commented that Drexler's return was the answer to the company's problems.¹⁶ But reentry by Drexler was an unlikely event given that he had been forced out of Gap, Inc. and was, at that time, focused on matters at his new employer, the J.Crew Group. Most observers expected a retail apparel veteran to take the helm to try to lead Gap, Inc. back to its former success. In a surprise decision, Glenn Murphy, having no apparel experience, was named CEO of the ailing retailer in July 2007.¹⁷

Murphy came to Gap, Inc. with 20 years of retail experience and demonstrated his ability to drive success after his contributions at Shoppers Drug Mart, Canada's largest drugstore chain. Murphy increased this company's success through successful marketing strategies, product and service introductions, and operational efficiencies.¹⁸ Prior to his tenure at Shoppers, he contributed to the success of Chapters', Canada's leading book retailer, by introducing improved marketing strategy and product improvements.¹⁹ In response to the appointment of Murphy, Robert Fisher commented, "He has revitalized major retail brands by offering new products and significantly improving the store experience...

He's well qualified to return Gap, Inc. to the level of sustained performance we all expect."²⁰ This comment indicated that Murphy was chosen for his ability to bring life back into a brand and that Fisher had confidence in his ability to do so at Gap, Inc.

Murphy solidified the leadership team by appointing new presidents for Old Navy, Banana Republic, and Outlet divisions, and chief financial officer and senior vice president of corporate real estate. Under Murphy, the Gap, Inc. senior management team developed a focus on revitalizing the brands and pursuing growth opportunities through the online division, international expansion and franchise partnerships.²¹ Autonomy of the brands was increased, with critical function moved from corporate back into the brands to make the decision making process more efficient. Notable improvements were also made in system management and in the supply chain.²²

The leadership team, with different backgrounds and viewpoints, has created an organizational structure that historically has served the company well.

Organizational Hierarchy

Gap, Inc.'s structural alignment is similar to how its products are positioned in the marketplace. Each core division has a president who is in charge of only that brand (see **Exhibit 3**). Only a limited relationship occurs between the brands; discussions,

Exhibit 3 The Gap Inc. Executive Leadership Team

Glenn K. Murphy

Chairman and Chief Executive Officer, Gap Inc.

Michelle Banks

SVP, General Counsel, and Corporate Secretary and Chief Compliance Officer, Gap Inc.

Jack Calhoun

President, Banana Republic

John Ermatinger

President, Asia Pacific Region, Gap Inc.

Marka Hansen

President, Gap North America

Tom Keiser

EVP, Chief Information Officer

Toby Lenk

President, Gap Inc. Direct

Art Peck

President, Gap Inc. Outlet; EVP, Strategy & Operations

Stan Raggio

EVP, Global Supply Chain, Gap Inc.

Eva Sage-Gavin

EVP, Global Human Resources and Corporate Affairs, Gap Inc.

Sabrina Simmons

EVP and Chief Financial Officer, Gap Inc.

Stephen Sunnucks

President, Europe and International Strategic Alliances, Gap Inc.

Tom Wyatt

President, Old Navy

David Zoba

SVP, Global Real Estate, Gap Inc.

decisions, and designs are not cross-branded. The responsibility for managing international operations is divided geographically, with presidents for both the Asia Pacific region and Europe. Additionally, the online division is treated separately and although the product is supplied by the brands, the direction and content are solely at the discretion of this division.

Supporting these divisions is a Corporate Shared Services Center. This organization supports the company's domestic and international back office operations, accounting, finance, human resources, procurement, information technology, and legal. This shared service model allows for minimization of redundant processes and functions across the different brands.

Brand Definition

Gap, Inc. constitutes five main brands in the marketplace: the flagship Gap brand, Old Navy, Banana Republic, Piperlime, and Athleta. Each brand is defined as follows.²³

Gap

Gap offers iconic American style to customers of all ages. Since 1969, customers have looked to Gap for updated casual clothing and accessories that help them express their own personal sense of style. Today, Gap continues to be the best destination for wardrobe essentials such as t-shirts, hoodies, great-fitting pants, and denim. What began as one brand has grown to include Gap, GapKids, babyGap, GapMaternity, and Gapbody.²⁴

Old Navy

Old Navy offers great fashion at great prices, for everyone.

Since 1994 Old Navy has been famous for bringing customers on-trend apparel and accessories, as well as updated basics, at a surprising value, all in a fun, energizing shopping environment. From Old Navy's Item of the Week—a special item at a special price each week—to its much-talked-about advertising campaigns, Old Navy is still the place to go for the latest fashion at amazing prices.²⁵

Banana Republic

Banana Republic is an accessible luxury brand, offering high-quality apparel and accessories collections for men and women.

Delivering elevated design and luxurious fabrications at approachable prices, Banana Republic

has been credited with helping make fashion more accessible. The brand offers elevated essentials and sophisticated seasonal collections of accessories, shoes, personal care products, and intimate apparel. From work to casual occasions, Banana Republic offers covetable, uncomplicated style.²⁶

Piperlime

Piperlime is a fresh online shop that handpicks the world's best shoes and handbags for women, men, and kids.

Their collection of more than 200 amazing brands features the hottest styles and designers. With a distinct fashion point of view, Piperlime shares fresh tips on the latest shoe and handbag trends. And exclusive contributions from guest editors like celebrity stylist Rachel Zoe keep you in fashion and in the know.²⁷

Athleta

Athleta: Be Strong. Be Beautiful

Designed and developed by women athletes for women athletes, every one of Athleta's products delivers the ultimate performance advantage. With feminine designs and fits dialed to your athletic physique, it is quality you can put to the test, workout after workout—and it is fashioned to take on your entire active lifestyle, from the daily runaround to the furthest off-grid adventure.²⁸

Gap, Inc. essentially tried to corner each section of the retail apparel market with its brand decisions (see **Exhibit 2**). Old Navy competes for the budget-conscious shopper; teenagers are the target customer group. Gap seeks to serve the needs of the everyday casual market. Although more moderately priced, the lure of Gap has been the style and substance—quality products that can withstand the wear and tear of the weekly grind yet still fit within most budgets. Banana Republic positions itself as the destination for customers seeking to buy the latest trends. Although not upscale to the point of couture or boutique in nature, this brand is meant to allow a person to go right from the office to an after-work event without a change of outfit.

Piperlime is an online-only enterprise. Piperlime sells shoes, handbags, clothing and accessories by brands not affiliated with the parent company. Originally, Piperlime only sold shoes, but later expanded its offerings to include handbags and accessories. In Fall 2009 it began to offer clothing. On September 9, 2010, Piperlime opened its first "Pop-Up" store in New York's SoHo neighborhood.

It was designed to be open for 25 days, beginning in New York Fashion Week and ending on October 3. Jennifer Gosselin, General Manager of Piperlime, stated, “We are excited to share this experience with the public. It’s the first time that Piperlime will be available in a three-dimensional environment, where customers can touch and feel product, put together head-to-toe outfits, and pick personal favorites from exclusive jewelry items to vintage-inspired tops to the must-have boot for fall.”²⁹

Athleta makes and sells women’s athletic wear (pants, tops, swimwear, hoodies and jackets, shoes, skorts), accessories (sunglasses, socks, hats, sports watches, fitness gear bags) and lifestyle items (CamelBak hydration gear, trendy footwear from UGG, Simple and Timberland brands). Founded in 1998, Athleta was acquired by Gap, Inc. in 2008 to enhance its women’s apparel collection. Athleta is a direct marketer and sells its merchandise through its catalog and online.³⁰

Engaging in related product diversification in the apparel industry put Gap, Inc. into competition with multiple and diverse competitors.

Key Competitors

The number of competitors for all of Gap, Inc.’s retail concepts or brands is extensive; however, each brand has its unique set of competitors. The retail industry includes numerous national brands and local retail stores; nonetheless, “Gap [Inc.] faces competition from every retail corner. Everyone from Nordstrom to American Eagle to Ann Taylor is taking its market share.”³¹ The competitive market is intense and retailers find it difficult to differentiate products between competitors. A brief list of competitors, as described by Mergent Online, includes TJX Companies, Nordstrom, Inc., Ross, Abercrombie & Fitch, American Eagle Outfitters, and J.Crew Group. Financial data about these and some of the other competitors is shown in **Exhibit 4**.

A key component to success in Gap, Inc.’s highly competitive and diverse environment is to select a target market in which the retailer focuses its products. Although Gap, Inc. professes to have this focus, it has essentially five brands attempting to effectively create value for a number of target customer groups: casual clothing at The Gap, value products at Old Navy, upscale clothing through its Banana Republic brand, shoes and accessories through Piperlime, and women’s fitness apparel and accessories through Athleta.

One of The Gap’s main competitors, Abercrombie & Fitch, has done an excellent job of targeting the teenage market, although like many of its competitors it has continued to struggle against the effects of the recession. Abercrombie & Fitch’s CEO Mike Jefferies described its strategy as follows:

“In every school there are the cool and popular kids, and then there are the not-so-cool kids... We go after the cool kids. We go after the attractive all-American kid with a great attitude and a lot of friends. A lot of people don’t belong (in our clothes), and they can’t belong. Are we exclusionary? Absolutely.”³²

This type of focus led to success at Abercrombie and illustrates the highly competitive nature of the market. In addition to this focus, Abercrombie added a new business, Hollister, to further segment the market and grab more of the teenage market share. By fall 2010 there were approximately 525 Hollister stores, 1,100 Abercrombie & Fitch stores, and 15 Gilly Hicks stores. Gilly Hicks launched in 2008 as a just-for-women brand. In addition, abercrombie kids offered products aimed at boys and girls aged 7 to 14.

Old Navy has competition in Kohls, Target, Ross, and Wal-Mart.³³ These competitors are more diverse outlets than Old Navy, carrying more than just clothing and accessories. These budget brands create value by utilizing economies of scale to keep prices low. In the budget market, price is the major discriminator for potential consumers. Although Old Navy recorded sales declines in 2007 and 2008, by 2009 it outperformed both Gap and Banana Republic, with a two percent gain in 2009 (over 2008) and same-store sales grew by three percent in 2009.

Athleta makes and sells women’s athletic wear and related accessories. Gap, Inc. purchased Athleta in 2008 as part of its strategy to diversify its brand offerings and enhance its women’s apparel collection. Gaiam, Inc., Lululemon Athletic, Inc., and NIKE, Inc. are considered Athleta’s top competitors.³⁴

Banana Republic has been growing in recent years and has identified competitors Ann Taylor, J.Crew, and Urban Outfitters.³⁵ Banana Republic is the highest end of the Gap, Inc. family of products, and with its narrow focus on professional clothing, it has traditionally been more successful than the other Gap, Inc. brands. Competitors in this group have taken differing actions in creating profitability; for example, the J.Crew Group was taken private and has a highly experienced leader in Millard Drexler, former Gap, Inc. CEO, at the helm.

Exhibit 4 Financial Data of Significant Competitors, 2010 (in \$ millions)

Company Name	Gross		Net Income	EBITDA	Total Assets		Total Liabilities		PE Ratio	Market Capital	Employees	Share Price
	Revenues	Margin			Total Assets	Total Liabilities						
TJX Companies, Inc.	20,288,444,000	26.22	1,213,572,000	1,993,271,000	7,463,977,000	4,574,701,000	14.1067	18,539 M	154,000	46.27		
The Gap, Inc.	14,197,000,000	40.32	1,102,000,000	2,464,000,000	7,985,000,000	3,094,000,000	11.6989	12,743 M	135,000	20.59		
Nordstrom, Inc.	8,627,000,000	38.24	441,000,000	1,105,000,000	6,579,000,000	5,007,000,000	18.2436	9,357 M	48,000	42.69		
Family Dollar Stores, Inc.	7,866,971,000	35.69	358,135,000	747,635,000	2,982,057,000	1,560,503,000	18.7824	6,195 M	30,000	49.21		
Ross Stores, Inc.	7,184,213,000	25.85	442,757,000	879,222,000	2,768,633,000	1,611,340,000	15.3602	7,808 M	13,300	64.82		
American Eagle Outfitters, Inc.	2,990,520,000	38.72	169,022,000	377,274,000	2,138,148,000	559,631,000	22.2432	3,221 M	6,400	16.46		
Abercrombie & Fitch Co.	2,928,626,000	64.32	254,000	309,482,000	2,821,866,000	993,949,000	44.5794	4,211 M	9,000	47.70		
Urban Outfitters, Inc.	1,937,815,000	40.57	219,893,000	424,262,000	1,636,093,000	339,318,000	24.2533	6,166 M	5,740	37.35		
Children's Place Retail Stores, Inc.	1,643,587,000	40.13	88,354,000	203,949,000	854,060,000	265,090,000	14.7781	1,324 M	4,400	48.62		
J.Crew Group, Inc.	1,578,042,000	44.08	123,360,000	265,968,000	738,558,000	362,680,000	15.06	2,400 M	3,400	37.65		
Stage Stores, Inc.	1,431,927,000	27.36	28,721,000	109,315,000	800,431,000	324,385,000	16.3218	535 M	13,100	14.20		
Stein Mart, Inc.	1,219,109,000	27.10	23,553,000	53,547,000	404,213,000	188,524,000	14	432 M	12,800	9.94		

Source: 2010, Company Details, The Gap, Mergent Online, www.mergentononline.com.ezproxy1.lib.asu.edu/CompDetail.asp?company_nmer=3551.

However, by fall of 2010 many of Gap, Inc.'s competitors were seeing sales slump as the result of the economic downturn and the wary nature of consumers. In November 2010 J.Crew Group agreed to a \$2.86 billion buyout. It had until January 15, 2011, to solicit better offers, and offers were anticipated to occur during the 2010 holiday season.³⁶

For each of Gap, Inc.'s brands to be successful they must assign a good portion of their budgets to new product development. When contemplating new products, it is important for Gap, Inc. to consider the relationship it has with its suppliers and how it will affect the time to launch the new product, the level of product quality, and other important issues.

Relationship with Suppliers

As indicated by fiscal year purchase data as reported in the 2009 Annual Report, Gap, Inc. limits the strength of any one supplier by maintaining a network of approximately 1,000 vendors with facilities in more than 60 separate countries.³⁷ Gap, Inc. also limits the share of each vendor, and no vendor accounted for more than three percent of the firm's overall purchases.³⁸

Gap, Inc.'s inventory system allows for prompt restocking and aids the company's product availability inventory turnover. This, in effect, enables Gap, Inc. to more easily introduce a greater number of products throughout the year to influence customers' interest in returning to the stores.³⁹

Former CEO Paul Pressler had explored the use of cooperative purchasing across the Gap, Inc. brands to provide customers the products and fashions they desire at lower costs. This approach had proven unsuccessful because designers and brands were constrained to too few options in materials to create significantly unique and desirable products. This practice was abandoned rather quickly once the impact was determined.

The use of contract suppliers to produce garments has proven challenging for Gap, Inc. Although it is a common practice in the industry to reduce overhead and capital investment, the practice provides less regulation of procedures, including quality and staffing. As mentioned previously, Gap, Inc. has dealt, multiple times, with contractors using child labor; and although competitors may also unknowingly contract with such vendors, Gap, Inc.'s size and reputation often increases the likelihood that they will be linked with such unacceptable practices.

Accordingly, Gap, Inc. remains committed to finding ways to communicate its expectations with vendors and to select the best vendors available as far as product quality, price, and regulation compliance are concerned.

In addition to the challenge of establishing relationships with the appropriate suppliers, Gap, Inc. faces other challenges in its competitive environment.

Competitive and Fashion Trends Affecting Gap, Inc. and the Apparel Industry

The success of Gap, Inc. and others in the highly competitive global specialty apparel retail industry depends largely on their ability to predict the fashion tastes of customers and provide merchandise that meets customer demand in a timely manner. Changes in consumer preferences are affected by fashion and season. Companies must effectively judge the market for their merchandise and the products suitable for local markets to remain competitive.⁴⁰

As the recession affected consumers differently, retailers made efforts to learn which products, qualities and values were important to their customers. According to the 2009 Annual Report, all of Gap, Inc.'s work in 2009 was focused on connecting with their customers. Consumers demanded more in 2009, and looked for value from trusted brands that addressed their individual needs. Old Navy used irreverent marketing and aggressive one-day promotions to appeal to its target customer, the average family. With the average family in mind, Old Navy aimed to deliver fashion at great value for the entire family. Old Navy customers indicated that they wanted a place that was fun, full of energy, where they could bring the entire family. In response, Old Navy developed a new store model. The 50 redesigned stores outperformed the others in sales and customer service levels, and more renovations were planned.⁴¹

In 2009 Gap, Inc. debuted its 1969 Premium Jeans Collection. All jeans in the collection retailed for \$70 and featured reworked denim with authentic details including hardware, seams, selvage hems, washed and stitching. Styles included the Always Skinny, Real Straight, Sexy Boot, and Slouchy Boyfriend. With such style variety, Gap could almost guarantee a flattering pair of jeans for every figure type. The jeans cuts would stay the same each season, but buttons washes and detailing would change to meet current trends.⁴²

Banana Republic customers indicated that they valued versatility. In response, Banana Republic, with its focus on “affordable luxury” adjusted both its product and marketing to show consumers that the apparel could be worn seven days per week and could easily transition from work to going out after work to weekend.⁴³

As convenience continued to be an important trend, Gap, Inc. expanded its online and outlet presence so more people could have access to the brands. Consumers could provide reviews on the website to deliver valuable customer feedback, and the e-commerce platform was enhanced to allow shoppers to purchase items from all brands using one shopping cart.⁴⁴

Classic denim continues to be considered an ageless fabric, and is used to make items from classic jeans to trendier offerings such as leggings and dresses. Classic jeans remain popular and can be combined with sneakers and sweatshirts for a comfortable feel or dressed up with shoes and accessories for the ultra chic or dressed down for the urban experience. By fall 2010 skinny jeans and denim miniskirts were popular trends, as well as “premium jeans” (the modern version of “designer” jeans with stylish cuts and popular “hot” labels), boyfriend jeans (holes, bleached spots and frayed edges with soft borrowed-from-him styling), and tummy control jeans.⁴⁵ In an effort to keep pace with current trends and the popularity of designer offerings from brands such as Joe’s Jeans, True Religion, Paige Denim, Chip & Pepper, Seven, etc., Gap, Inc. has partnered with Italian designer Valentino to offer a seven-piece collection featuring a “military-meets-ruffles” theme with pants, parkas and Khaki green cotton jackets. Included in the collection are pieces familiar to Gap’s target customer such as cargo pants, a gray T-shirt and a hoodie. The message for customers is to cut costs, not style, and Valentino’s top designers Maria Grazia Chiuri and Pier Paolo Piccioli stated, “We love mixing different cultures and we have been excited to mix Gap’s timeless essentials with our roman culture of Coutoure. It brings together the iconic world of Valentino and Gap’s fashion staples, synthesizing the current trend of combining luxury with basics.”⁴⁶

In fall 2010 Gap, Inc. introduced their newest premium pant collection, the Black Magic collection. Black Magic pants were offered in styles and sizes to fit every woman, and were designed to be worn in both a professional setting and after work hours. There were seven different cuts in the collection:

the Perfect Trouser, the Modern Boot, the Curvy, the True Straight, the Really Skinny, the Slim Crop, and the Boy Fit. Select styles were offered in three colors: True Black, Gray, and Basic Navy. All were affordably priced at \$49.50 to \$59.50 each.⁴⁷

The majority of Gap, Inc.’s brands are “American” in style and level of product quality. Although well suited for American tastes, the casual and trendy styles that Gap, Inc. offers have limited the firm’s international growth in the past. However, by 2010 the brands had gained global recognition for their link to American style and pop culture. Asia, Europe and Canada each represented approximately five to six percent of net sales from 2007 through 2009. However, net sales for the Asia region have increased each year by one percent, from five percent in fiscal year 2007 to seven percent in 2009.⁴⁸ As Gap, Inc. expands into China in 2010 and 2011, this percentage amount is likely to increase. Gap, Inc. has performed research on Chinese consumer trends and preferences and has modified some of its product offerings for the Chinese market. As Gap, Inc. expands into Italy, the addition of Valentino’s collection should increase the appeal of Gap products in the Italian and European markets. Revenues generated from foreign operations are presented in **Exhibit 5**.

Financial Results

Recent Financial Information

Financial results for third quarter 2010, which ended October 30, 2010, were positive and driven mostly from international expansion and e-commerce growth.⁴⁹ Diluted earnings per share increased nine percent to \$0.48 from \$0.44 the previous year. Net sales increased two percent to \$3.65 billion, compared with \$3.59 billion in third quarter 2009. Operating income increased one percent to \$504 million from \$500 million in fiscal year 2009, and the gross margin of 41.2 percent and operating margin of 13.8 percent indicated the second-best third quarter performance in ten years. Year to date, Gap repurchased approximately 67 million shares for \$1.4 billion. Financial information for Gap, Inc. can be found in the annual income statement and balance sheet in **Exhibits 6a** and **6b**.⁵⁰

On November 26, 2010, the official beginning of the 2010 holiday season, Gap, Inc. stock price was at \$20.90, an increase from the end of fiscal year 2009 price of \$19.08. The stock’s fair value estimate according to the Morningstar Investment Research Center was \$20.00 with a rating of three

Exhibit 5 Gap Inc. Sales by Division and International Region

(In \$ millions)						Percentage of Net Sales
Fiscal Year 2009	Gap	Old Navy	Banana Republic	Other³	Total	
U.S. ¹	3,508	4,949	2,034	—	10,491	74
Canada	312	386	162	—	860	6
Europe	683	—	24	36	743	5
Asia	774	—	106	48	928	7
Other regions	—	—	—	57	57	—
Total stores reportable segment	5,277	5,335	2,326	141	13,079	92
Direct reportable segment ²	324	473	134	187	1,118	8
Total	5,601	5,808	2,460	328	14,197	100
Sales growth (Decline)	(6)%	2%	(7)%	46%	(2)%	

Fiscal Year 2008	Gap	Old Navy	Banana Republic	Other³	Total	Percentage of Net Sales
U.S. ¹	3,840	4,840	2,221	—	10,901	75
Canada	329	392	146	—	867	6
Europe	724	—	23	33	780	6
Asia	732	—	101	47	880	6
Other regions	—	—	—	68	68	—
Total stores reportable segment	5,625	5,232	2,491	148	13,496	93
Direct reportable segment ²	333	475	145	77	1,030	7
Total	5,958	5,707	2,636	225	14,526	100
Sales growth (Decline)	(5)%	(14)%	(3)%	84%	(8)%	

Fiscal Year 2007	Gap	Old Navy	Banana Republic	Other³	Total	Percentage of Net Sales
U.S. ¹	4,146	5,776	2,351	—	12,273	78
Canada	364	461	147	—	972	6
Europe	822	—	—	5	827	5
Asia	613	—	89	36	738	5
Other regions	—	—	—	50	50	—
Total stores reportable segment	5,945	6,237	2,587	91	14,860	94
Direct reportable segment ²	308	428	136	31	903	6
Total	6,253	6,665	2,723	122	15,763	100
Sales growth (Decline)	(4)%	(2)%	7%	213%	(1)%	

¹ U.S. includes the United States and Puerto Rico.

² U.S. only. Direct includes Athleta beginning September 2008.

³ Other includes our wholesale business, franchise business, Piperlime, and beginning September 2008, Athleta.

Source: The Gap Inc. 2009 Annual Report

stars, indicating that the stock should offer a “fair return,” which meant that it was a stock that would adequately compensate for its riskiness. Morningstar projected that Gap, Inc. would post low-single-digit topline growth over the next several years, and that operating margins would contract slightly to the

low double digits in the short term, which would be below the projected 13 percent in 2010. This would be due in large part to higher sourcing costs and expenses associated with international expansion.⁵¹ (See Exhibit 7 for information on Gap, Inc.’s historic stock prices.)

Exhibit 6a Gap Inc. Income Statement, 2007–2009

(In \$ millions, except per share amounts)	Consolidated Statements of Income		
	Fiscal year		
	2009	2008	2007
Net sales	14,197	14,526	15,763
Cost of goods sold and occupancy expenses	<u>8,473</u>	<u>9,079</u>	<u>10,071</u>
Gross profit	5,724	5,447	5,692
Operating expenses	<u>3,909</u>	<u>3,899</u>	<u>4,377</u>
Operating income	1,815	1,548	1,315
Interest expense	6	1	26
Interest income	<u>(7)</u>	<u>(37)</u>	<u>(117)</u>
Income from continuing operations before income taxes	1,816	1,584	1,406
Income taxes	<u>714</u>	<u>617</u>	<u>539</u>
Income from continuing operation, net of income taxes	1,102	967	867
Loss from discontinued operations, net of income tax benefit	<u>—</u>	<u>—</u>	<u>(34)</u>
Net income	<u>1,102</u>	<u>967</u>	<u>833</u>
Weighted-average number of shares—basic	694	716	791
Weighted-average number of shares—diluted	699	719	794
Earnings (loss) per share—basic			
Income from continuing operations, net of income taxes	1.59	1.35	1.10
Loss from discontinued operation, net of income tax benefit	<u>—</u>	<u>—</u>	<u>(0.05)</u>
Earnings per share	<u>1.59</u>	<u>1.35</u>	<u>1.05</u>
Earnings (loss) per share—diluted			
Income from continuing operations, net of income taxes	1.58	1.34	1.09
Loss from discontinued operation, net of income tax benefit	<u>—</u>	<u>—</u>	<u>(0.04)</u>
Earnings per share	<u>1.58</u>	<u>1.34</u>	<u>1.05</u>
Cash dividends declared and paid per share	0.34	0.34	0.32

Source: The Gap Inc. 2009 Annual Report

Exhibit 6b Gap Inc. Balance Sheet, 2008–2009

(In \$ millions, except par value)	Consolidated Balance Sheets	
	January 30, 2010	January 31, 2009
Assets		
Current assets		
Cash and cash equivalents	2,348	1,715
Short-term investments	225	—
Restricted cash	18	41
Merchandise inventory	1,477	1,506
Other current assets	<u>596</u>	<u>743</u>
Total current assets	4,664	4,005
Property and equipment, net	2,628	2,933
Other long-term assets	<u>693</u>	<u>626</u>
Total assets	<u>7,985</u>	<u>7,564</u>

(Continued)

Exhibit 6b (Continued)

(In \$ millions, except par value)	January 30, 2010	January 31, 2009
Liabilities and Stockholders' Equity		
Current liabilities		
Current maturities of long-term debt	—	50
Accounts payable	1,027	975
Accrued expenses and other current liabilities	1,063	1,076
Income tax payable	41	57
Total current liabilities	<u>2,131</u>	<u>2,158</u>
Lease incentives and other long-term liabilities	963	1,019
Commitments and contingencies (see Notes 11 and 15)		
Stockholders' equity		
Common stock \$0.05 par value		
Authorized 2,300 shares; Issued 1,106 and 1,105 shares;		
Outstanding 676 and 694 shares	55	55
Additional paid-in capital	2,935	2,895
Retained earnings	10,815	9,947
Accumulated other comprehensive income	155	123
Treasury stock, at cost (430 and 411 shares)	<u>(9,069)</u>	<u>(8,633)</u>
Total stockholders' equity	<u>4,891</u>	<u>4,387</u>
Total liabilities and stockholders' equity	<u>7,985</u>	<u>7,564</u>

Source: The Gap Inc. 2009 Annual Report

Comparative Trends and Key Ratios

The Gap, Inc.'s focus on cost management, healthy merchandise margins and strong cash generation allowed it to increase the earnings per share by

18 percent. Fiscal year 2009 ended with \$2.3 billion in cash and no debt.⁵² Although sales have been weak, Gap, Inc. has generated a strong cash flow (see Exhibit 8) and healthy profit margins.⁵³ Exhibit 9 compares Gap, Inc. to its major competitors

Exhibit 7 The Gap Inc. Stock Price, 2001–2010

Year	Stock Price (\$)			P/E		Per Share (\$)		Book Value
	FY High	FY Low	FY Close	High	Low	Earns.	Div.	
Jan 2010	23.36	9.56	19.08	15	6	1.58	0.34	7.90
Jan 2009	21.89	9.41	11.28	16	7	1.34	0.34	7.09
Jan 2008	22.02	15.20	19.09	21	14	1.05	0.32	6.91
Jan 2007	21.39	15.91	19.17	23	17	0.93	0.32	8.36
Jan 2006	22.70	15.90	18.09	18	13	1.24	0.18	8.77
Jan 2005	25.72	18.12	22.01	21	15	1.21	0.11	7.98
Jan 2004	23.47	12.45	18.58	22	11	1.09	0.09	7.73
Jan 2003	17.14	8.35	14.63	32	15	0.54	0.09	5.91
Jan 2002	34.98	11.12	14.40	—	—	(0.01)	0.09	4.86
Jan 2001	53.13	18.50	32.60	53	19	1.00	0.09	4.73

Source: Hoover's Company Reports, 2010, The Gap Inc., <http://premium.hoovers.com.ezproxy1.lib.asu.edu/subscribe/co/fin/history.xhtml?ID=ffffrcjfcxjtjsh>.

Exhibit 8 Gap Inc. Cash Flow, 2007–2009

The Gap, Inc.			
Consolidated Statements of Cash Flows			
(In \$ millions, except for per share amounts)	Fiscal Year		
	2009	2008	2007
Cash flows from operating activities			
Net income	1,102	967	833
Adjustments to reconcile net income to net cash provided by operating activities			
Depreciation and amortization	655	653	635
Amortization of lease incentives	(82)	(85)	(88)
Share-based compensation	64	55	52
Tax benefit from exercise of stock options and vesting of stock units	(2)	5	8
Excess tax benefit from exercise of stock options and vesting of stock units	(4)	(6)	(7)
Noncash and other items	16	61	54
Deferred income taxes	(50)	10	(51)
Changes in operating assets and liabilities			
Merchandise inventory	43	51	252
Other current assets and other long-term assets	83	34	18
Accounts payable	40	(4)	199
Accrued expenses and other current liabilities	(23)	(284)	32
Income taxes payable, net of prepaid and other tax-related items	64	(94)	(4)
Lease incentives and other long-term liabilities	<u>22</u>	<u>49</u>	<u>148</u>
Net cash provided by operating activities	<u>1,928</u>	<u>1,412</u>	<u>2,081</u>
Cash flows from investing activities			
Purchases of property and equipment	(334)	(431)	(682)
Proceeds from sale of property and equipment	1	1	11
Purchases of short-term investments	(350)	(75)	(894)
Maturities of short-term investments	125	251	1,287
Acquisition of business, net of cash acquired	—	(142)	—
Change in restricted cash	21	(1)	7
Change in other long-term assets	<u>—</u>	<u>(1)</u>	<u>(3)</u>
Net cash used for investing activities	<u>(537)</u>	<u>(398)</u>	<u>(274)</u>
Cash flows from financing activities			
Payments of long-term debt	(50)	(138)	(326)
Proceeds from share-based compensation, net of withholding tax payments	56	75	125
Repurchases of common stock	(547)	(705)	(1,700)
Excess tax benefit from exercise of stock options and vesting of stock units ..	4	6	7
Cash dividends paid	<u>(234)</u>	<u>(243)</u>	<u>(252)</u>
Net cash used for financing activities	<u>(771)</u>	<u>(1,005)</u>	<u>(2,146)</u>
Effect of foreign exchange rate fluctuations on cash	<u>13</u>	<u>(18)</u>	<u>33</u>
Net increase (decrease) in cash and cash equivalents	633	(9)	(306)
Cash and cash equivalents at beginning of period	<u>1,715</u>	<u>1,724</u>	<u>2,030</u>
Cash and cash equivalents at end of period	<u>2,348</u>	<u>1,715</u>	<u>1,724</u>

(Continued)

Exhibit 8 (Continued)

(In \$ millions, except for per share amounts)	Fiscal Year		
	2009	2008	2007
Noncash investing activities			
Purchases of property and equipment, not yet paid at end of period	37	35	55
Supplemental disclosure of cash flow information			
Cash paid for interest during the period	3	17	39
Cash paid for income taxes during the period	702	674	535

Source: The Gap Inc. 2009 Annual Report.

Exhibit 9 Comparative Financial Outcomes of Gap Inc. to Primary Competitors, 2010

Competitive Landscape

Key Numbers	The Gap	American Eagle Outfitters	J.Crew	TJX Companies		
Annual sales (\$ mil.)	14,197.0	2,990.5	1,578.0	20,288.4		
Employees	135,000	39,400	12,000	154,000		
Market cap (\$ mil.)	12,810.9	3,177.6	2,325.9	18,466.5		
Profitability (%)	The Gap	American Eagle Outfitters	J.Crew	TJX Companies	Industry Median	Market Median ²
Gross profit margin	40.32	38.72	46.38	26.22	37.03	28.77
Pretax profit margin	12.79	7.60	16.14	9.62	9.36	8.48
Net profit margin	7.76	4.57	9.67	5.98	5.80	5.53
Return on equity	23.8	9.8	44.4	48.3	22.2	10.1
Return on assets	14.2	7.2	22.4	17.8	11.3	1.5
Return on invested capital	23.6	9.5	36.9	36.8	17.9	4.4
Valuation	The Gap	American Eagle Outfitters	J.Crew	TJX Companies	Industry Median	Market Median ²
Price/sales ratio	0.97	1.12	1.42	0.91	0.99	3.68
Price/earnings ratio	11.79	20.58	14.64	13.99	16.67	27.03
Price/book ratio	2.95	2.31	5.01	5.94	3.61	7.15
Price/cash flow ratio	8.06	10.68	11.68	8.64	8.96	22.88
Operations	The Gap	American Eagle Outfitters	J.Crew	TJX Companies	Industry Median	Market Median ²
Days of sales outstanding	— ¹	4.96	— ¹	2.62	3.77	34.66
Inventory turnover	5.7	5.3	4.4	5.8	4.7	8.1
Days cost of goods sold in inventory	64	69	83	63	78	45
Asset turnover	1.8	1.6	2.3	3.0	1.9	0.3
Net receivables turnover flow	— ¹	73.7	— ¹	139.1	96.8	10.5
Effective tax rate (%)	39.3	28.7	40.1	37.8	— ¹	37.9

(Continued)


Exhibit 9 (Continued)

Financial	The Gap	American Eagle Outfitters	J.Crew	TJX Companies	Industry Median	Market Median ²
Current ratio	2.19	2.85	2.21	1.66	2.09	1.33
Quick ratio	1.2	1.8	1.3	0.7	1.1	1.2
Leverage ratio	1.63	1.35	1.96	2.58	1.96	7.13
Total debt/equity	0.00	0.02	0.13	0.27	0.21	1.37
Interest coverage	303.67	— ¹	58.05	— ¹	18.74	17.33
Per Share Data (\$)	The Gap	American Eagle Outfitters	J.Crew	TJX Companies	Industry Median	Market Median ²
Revenue per share	21.25	14.57	25.79	50.86	26.22	7.60
Dividends per share	— ¹	0.41	— ¹	— ¹	0.43	0.25
Cash flow per share	2.57	1.52	3.12	5.34	2.88	1.22
Working capital per share	4.09	3.88	4.46	4.76	4.08	0.64
Long-term debt per share	— ¹	— ¹	0.77	1.97	1.56	4.06
Book value per share	7.02	7.05	7.28	7.76	7.16	3.91
Total assets per share	12.90	10.93	11.59	18.63	13.99	27.90
Growth (%)	The Gap	American Eagle Outfitters	J.Crew	TJX Companies	Industry Median	Market Median ²
12-month revenue growth	(2.3)	0.1	10.5	6.8	2.3	31.9
12-month net income growth	14.0	(5.6)	128.0	37.8	85.0	(27.7)
12-month EPS growth	17.9	(5.8)	124.7	36.5	50.0	(50.0)
12-month dividend growth	0.0	0.0	— ¹	42.4	(2.0)	— ¹
36-month revenue growth	(3.8)	2.3	11.1	5.2	0.6	14.3
36-month net income growth	12.3	(24.2)	16.6	18.0	(0.8)	(5.6)
36-month EPS growth	19.3	(21.9)	8.6	20.3	0.3	(14.7)
36-month dividend growth	2.0	13.3	— ¹	18.8	1.5	— ¹

¹Data unavailable.

²Public companies trading on the New York Stock Exchange, the American Stock Exchange, and the NASDAQ National Market.

KEY: **Best of Group.** Companies listed are top competitors.

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Source: 2010, Competitive Landscape, The Gap Inc.; Hoover's Online, <http://premium.hoovers.com.ezproxy1.lib.asu.edu/s>.

American Eagle Outfitters, J.Crew, and TJX and industry averages. Among these competitors, Gap, Inc. had the highest price-to-earnings ratio, which suggests that investors valued Gap, Inc. above its competitors.⁵⁴ In addition, Gap, Inc.'s gross profit margin of 40.32 percent was above the industry average of 37.03 percent. It is difficult to solely evaluate the Gap, Inc. against these competitors because the company is much larger than specialty clothing stores American Eagle and J.Crew. Gap, Inc. also competes with large discount stores such as Kohls, Target and Wal-Mart, which are also considered to be in the same industry. Comparisons with these larger stores are difficult because they sell more general household goods.

Strategic Challenges

In the early 2000s GAP, Inc. had established a strong portfolio of highly respected brands, including Gap, Old Navy, and Banana Republic. These brands appealed to a wide range of consumers, at different ages and income levels. However, there were almost no barriers to entry into the specialty retail apparel market, and no customer switching costs. Competitors such as J.Crew, American Eagle, Abercrombie, Target, Kohls, and Wal-Mart made advances to take part of Gap, Inc.'s market share. Gap, Inc. attempted to move from its signature basic designs to designs it hoped would attract the younger and trendier customers. Customers who were loyal to the basic designs felt neglected and turned to other retailers, which resulted in five years of revenue declines from fiscal year 2005 to 2009.⁵⁵

Although Gap, Inc. made progress in 2010 as signs of economic recovery began to appear, analysts believe that it will be difficult for Gap, Inc. to build sustainable growth over the long term. It would be relatively easy for competitors to copy Gap's designs and marketing strategies. "Fast-fashion" chains that offer the latest trends at lower prices, such as Inditex's Zara, H&M, and Forever 21, are becoming increasingly popular. In addition, competition is extremely fierce in the European and Asian markets. Consumers are more fashion conscious, and once past the initial popularity of Western styles, Gap, Inc. will need to keep pace with changing trends in different regions to remain competitive. It will need to offer something unique to find a way of differentiating itself from existing apparel brands in these regions.⁵⁶ Although differentiation has not been one of Gap, Inc.'s strengths in the past, in the constantly

changing world of fashion, past performance does not necessarily predict future outcomes.

Numerous additional challenges face Gap, Inc. that include but are not limited to the following:⁵⁷

- Attracting consumer traffic
- Sourcing merchandise efficiently
- Competitively pricing products and achieving customer perception of value
- Anticipating and quickly responding to changing fashion trends and consumer demands
- Maintaining favorable brand recognition and effectively marketing products to consumers in several diverse market segments
- Developing innovative, high-quality products in sizes, colors, and styles that appeal to consumers of varying groups and tastes
- Providing strong and effective marketing support

Although analysts predict that Gap, Inc. will be able to maintain a modest growth rate for the next several years, it is difficult to determine if their current strategies will enable them to retain their loyal U.S. customers while at the same time develop unique offerings for the more fashion-forward Asian and European customers as they proceed with their plan of international expansion.

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