

www.gapinc.com, GPS

The Gap Inc. (Gap) is a popular retailer providing clothing, accessories, and personal-care products for men, women, children, and babies under Gap, Old Navy, Banana Republic, Intermix, Weddington Way, Piperlime, and Athleta brands. Stores are located in the United States, Canada, China, the U.K., France, Ireland, Italy, Taiwan, Mexico, and Japan. Franchise agreements expand operations into Asia, Australia, Europe, Latin America, Africa, and the Middle East. Gap employs about 135,000 full and part-time people at 3,200 company-owned store locations that are almost all under a lease agreement. Customers can shop online at gap.com, oldnavy.com, bananarepublic.com, and athleta.com. Other Gap-owned retail outlets include GapBody, GapKids, and BabyGap. Weddington Way does not have a material impact on Gap's financial statements.

Gap provides a wide range of family clothing products, including denim, khakis, T-shirts, fashion apparel, shoes, accessories, intimate apparel, and personal care products. All Gap clothing is private-label merchandise made specifically for the company. From the design board to store displays, Gap controls all aspects of its trademark casual look.

As indicated in the following numbers, the company needs a clear strategic plan going forward. Fiscal year 2017 company's sales were up 3 percent compared with a decline of 2 percent the prior year. Sales by brand for fiscal year 2017 were as follows:

- **Old Navy Global:** up 6 percent versus down 1 percent the prior year
- **Gap Global:** down 1 percent versus down 3 percent the prior year
- **Banana Republic Global:** down 2 percent versus down 7 percent the prior year

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History

In 1969, Doris and Don Fisher entered the clothing retail business with the vision of creating a unique shopping experience that offered a wide selection of styles. The idea behind the first Gap store, founded in San Francisco, was to provide fresh, casual, American style clothes. By 1970, sales reached \$2 million and the company opened its second store in San Jose, California. Six years later, in 1976, the company underwent major changes and initiated its first public offering of 1.2 million shares of stock on the New York and Pacific Stock Exchange.

The 1980s was a period of major growth and expansion. In 1980, Gap dropped Levis and other brands and began focusing on its own private label. In 1983, Gap expanded horizontally by acquiring Banana Republic, as well as expanding its product line and introducing GapKids with the opening of its first store in San Mateo, California. A year later, Gap burst into the international market and established its presence in London, England, and Vancouver, British Columbia. The same year, Gap entered the European market and Gap's annual sales reached \$1 billion.

In 2005, Gap revamped its online stores by offering more convenience and interactive shopping. The following year, Gap added PiperLime to its online brands. In 2008, the company acquired Athleta Inc., a women's sports and active apparel company based in Petaluma, California, for \$148 million. Gap opened its first stores in Serbia and Ukraine in 2011, broadening the clothing chain's reach into Eastern Europe. Gap stores opened early 2018 in Belgrade and Kiev. Stephen Sunnucks, Gap's international president, said in a statement that Ukraine is the fastest-growing retail market in Eastern Europe, while Serbia has many young customers who enjoy shopping.

Vision/Mission

Gap provides extensive literature and discussion on their corporate website regarding its efforts to enhance sustainability and take care of employees. Gap does not, however, report a written vision or mission statement. However, from reviewing current and past *Annual Reports*, a possible mission could look something like the following:

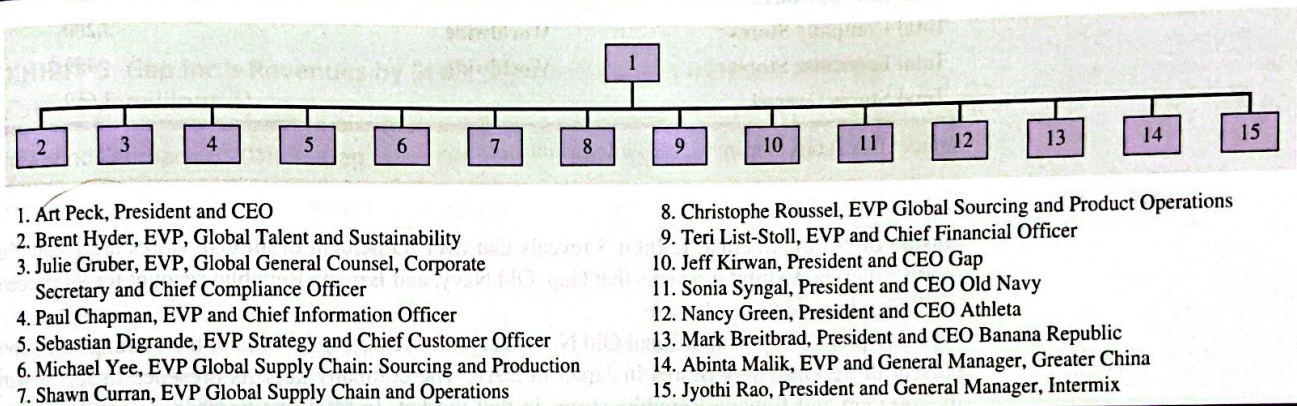
Gap strives to be a leader in the specialty family clothing industry offering excellent value to consumers by providing quality products at a fair price throughout North America, Asia, and Europe. Gap strives to minimize its environmental impact on raw materials with special consideration for both Gap employees and persons employed all along its supply chain. Gap is committed to producing lasting and positive relationships in all communities it impacts.

Internal Issues

Organizational Structure

Gap's organizational structure is provided in Exhibit 1. Of the 15 people listed, 6 are women. It appears the firm operates under a divisional-by-product structure, but there are duplicate titles of President and CEO for numerous positions, and there is no COO. Apparently every top executive reports to Art Peck.

EXHIBIT 1 Gap Inc.'s Top Executives and Organizational Chart



Source: Based on company documents.

Sustainability

Gap's sustainability strategy is aligned with the United Nations Global Sustainable Development Agenda that focuses on human rights, and the Paris Agreement that focuses on climate, and other sustainability programs. Gap is committed to ensuring its 135,000 employees and millions of people within its supply chain are paid fairly and work in safe conditions, as outlined in the company's five focus areas on core sustainability. Also included among the five key areas are water stewardship, product sustainability, and operational eco-efficiency. All areas are geared toward taking care of employees, and ensuring a small environmental footprint on all Gap products produced.

Segment Data

Gap primarily operates under Gap, Old Navy, Banana Republic, Athleta, and Intermix brands focusing primarily on clothing in all business segments. The company controls store layouts, marketing, brand development, and virtually all other vital factors for its full line of stores. Gap specializes in offering trendy but casual American style clothing focusing on denim, T-shirts, button-downs, khakis, and other casual styles of clothing and focusing on providing an affordable product though moderate price points. GapKids, GapBody, GapFit, babyGap, GapMaternity are common marketing names utilized by Gap. Customers can shop Gap at retail stores, outlet and factory stores, and on Gap's website. Gap stores account for 41 percent of all The Gap Inc. stores.

The company provides revenues by both geographic region and by store brand on their *Annual Report*. Exhibit 2 reveals the number of store locations by geographic region and store brand. Note there are nearly 25 percent more Old Navy stores in North America than Gap stores, but only 2 percent of international stores are Old Navy with 88 percent of international stores being Gap. Also, around 12.5 percent of all company stores are franchised owned, primarily all

EXHIBIT 2 Gap Inc. Store Demographics (2017 data)

Store	Region	Number of Locations
	North America	844
Gap	North America	1,043
Old Navy	North America	601
Banana Republic	North America	132
Athleta	North America	43
Intermix	North America	2,663
Total North America Stores		311
	Asia	13
Gap	Asia	13
Old Navy	Asia	48
Banana Republic	Asia	372
Total Asia Stores		164
	Europe	1
Gap	Europe	1
Banana Republic	Europe	165
Total Europe Stores		166
Total Company Stores	Worldwide	3,200
Total Franchise Stores	Worldwide	459
Total Stores Overall		3,659

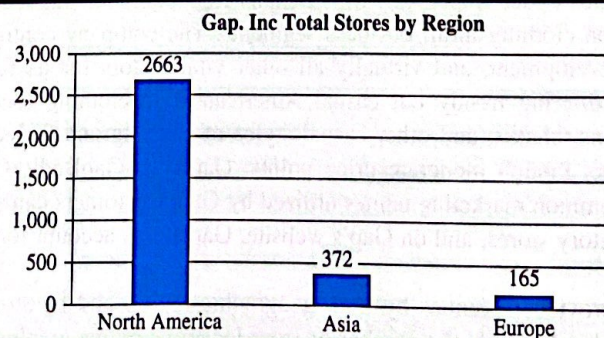
Source: Based on company website information.

outside of North America. Exhibit 3 reveals that over 83 percent of all Gap stores are located in North America. Exhibit 4 reveals that Gap, Old Navy, and Banana Republic account for 94 percent of all Gap Inc. stores worldwide.

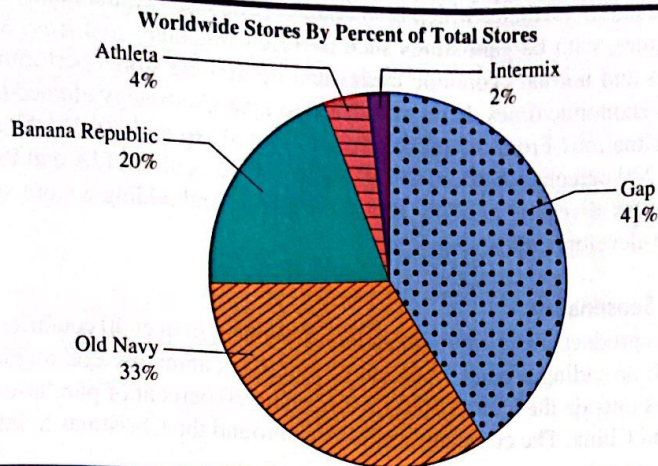
Gap plans to open additional Old Navy stores in Mexico and China in the coming years, but closed all 53 Old Navy Stores in Japan in 2016. The company kept its presence in Japan with its 200 Gap and Banana Republic stores in that market. In total, the company closed 67 stores worldwide in 2016, revealing how important branding is among different nations; a one-size-fits-all approach does not apply; for example all but 13 of the 1,056 Old Navy stores are located in North America.

Athleta focuses on premium fitness and performance apparel focused on women and girls. The business focus is on yoga, sports, and everyday activities. The Gap Inc. acquired Intermix in 2012.

Exhibit 5 and Exhibit 6 reveal the company's revenues and number of locations across regions and store type, respectively. Fiscal 2017 ended February 3, 2018. The U.S. region includes Puerto Rico and Guam. Fiscal 2017 results showed a substantial drop in company revenues in the United States, Canada, Europe, and Asia and across all brands, except slight increases in revenues from "Other Regions" and "Other Brands."

EXHIBIT 3 The Gap Inc.'s Total Stores by Region in 2017

Source: Based on company website information.

EXHIBIT 4 The Gap Inc. Worldwide Stores Percent Data for 2017

Source: Based on company website information.

EXHIBIT 5 Gap Inc.'s Revenues by Store Type and Region in Fiscal 2017 (in millions \$)

Year End February 3, 2018	Gap	Old Navy	Banana Republic	Other	Total
U.S. & Canada	\$3,463	\$7,117	\$2,242	\$919	\$13,741
Asia	1,117	50	96	0	1,263
Europe	626	0	15	0	641
Other Regions	112	71	27	0	210
Total	\$5,318	\$7,238	\$2,380	\$919	\$15,855

Source: Based on company documents.

EXHIBIT 6 Gap Inc.'s Number of Store Locations on 11-1-17 versus 2-1-18

Division	# of Stores on 11-1-17	# of Stores on 2-1-18
Gap North America	835	810
Gap Asia	309	313
Gap Europe	157	155
Old Navy North America	1,057	1,066
Old Navy Asia	13	14
Banana Republic North America	596	576
Banana Republic Asia	48	45
Athleta North America	140	148
Intermix North America	38	38
Company-operated stores total	3,193	3,165
Franchised stores total	446	429
Grand total	3,636	3,594

Source: Based on company documents.

Current Strategies

Cost cutting and efficiencies along the value chain are planned to improve the company's short-term bottom line, but these initiatives going forward cannot assure a sustainable competitive advantage. The company must be diligent in deciding where to sell what. A strategic issue facing

the company moving forward is whether the company should continue to add store locations in the United States, and if so, under which brand names? Historically, the family clothing business is bimodal in nature, with bargain stores such as TJX Companies and Ross Stores doing well during recessions and normal economic cycles and higher-end stores performing better during more prosperous economic times. How well is the company's strategy aligned to take advantage of this bimodal situation? From the market bottom in 2002 to early 2018, the company's stock price rose about 220 percent compared to 760 and 2,100 percent for TJX and Ross, respectively. Should Gap consider divesting possibly Banana Republic and adding a store similar to Ross or TJX as a product-development strategy?

Production and Seasonality

Gap purchases its products from approximately 800 vendors in over 40 countries, with the largest two vendors both providing around 5 percent of purchases annually. The majority of purchases are from factories outside the United States with around 50 percent of purchases coming equally from Vietnam and China. The company's sales peak around the Christmas holiday period.

Finance

The company's sales decreased about 2 percent in fiscal 2016 (year ending January 2017). The bulk of the decline was from reduced net sales at Gap and Banana Republic, with exchange rate losses only accounting for \$20 million. However, more alarmingly, net income was down over 26 percent over the same time period due mostly to a substantial increase in operating expenses. In fiscal 2015, total net sales declined \$638 million. The company pays a \$0.92 dividend and plans to re-initiate its \$1 billion share repurchase plan in fiscal 2017 (year ending January 2018). Interesting use of the term "re-initiate" by The Gap Inc. as the firm listed \$0 for treasury stock on its balance sheets, but did record treasury stock in fiscal 2014. The firm has \$1.25 billion in long-term debt at a surprisingly high fixed rate of 5.95 percent through April 2021. From purchasing Athleta and Intermix in recent years, Gap Inc. reports a nominal amount of goodwill on the balance sheet.

The Gap's income statements and balance sheets are provided in Exhibit 7 and Exhibit 8, respectively, for fiscal 2016 and 2017. For fiscal 2017 that ended February 3, 2018, The Gap Inc.'s revenues were \$15.9 billion, up slightly from the prior year. The company ended fiscal 2017 with 3,594 store locations; among these were 3,165 company-operated as opposed to being franchised.

EXHIBIT 7 Gap Inc.'s Income Statements (in millions \$)

Income Statement	1/28/17	2/3/18		Percent Change
Revenues	\$15,516	\$15,855	↑	2.18%
Cost of Goods Sold	9,876	9,789	↓	-0.88%
Gross Profit	5,640	6,066	↑	7.55%
Operating Expenses	4,441	4,568	↑	2.86%
EBIT	1,199	1,498	↑	24.94%
Interest Expense	75	74	↓	-1.33%
EBT	1,124	1,424	↑	26.69%
Tax	448	576	↑	28.57%
Non-Recurring Events	0	0	NA	NA
Net Income	676	848	↑	25.44%

Source: Based on company documents.

EXHIBIT 8 Gap Inc.'s Balance Sheets (in millions of \$)

Balance Sheet	1/28/17	2/3/18		Percent Change
Assets				
Cash and Equivalents	\$1,783	\$1,783	→	0%
Accounts Receivable	0	0	NA	NA
Inventory	1,830	1,997	↑	9%
Other Current Assets	702	788	↑	12%
Total Current Assets	4,315	4,568	↑	6%
Property Plant & Equipment	2,616	2,805	↑	7%
Goodwill	0	0	NA	NA
Intangibles	0	0	NA	NA
Other Long-Term Assets	679	616	↓	-9%
Total Assets	7,610	7,989	↑	5%
Liabilities				
Accounts Payable	2,388	2,461	↑	3%
Other Current Liabilities	65	0	↓	-100%
Total Current Liabilities	2,453	2,461	↑	0%
Long-Term Debt	1,248	1,249	↑	0%
Other Long-Term Liabilities	1,005	1,135	↑	13%
Total Liabilities	4,706	4,845	↑	3%
Equity				
Common Stock	20	19	↓	-5%
Retained Earnings	2,749	3,081	↑	12%
Treasury Stock	0	0	NA	NA
Paid in Capital & Other	135	44	↓	-67%
Total Equity	2,904	3,144	↑	8%
Total Liabilities and Equity	7,610	7,989	↑	5%

Source: Based on company documents.

Competitors

The family clothing business in the United States is highly fragmented, with over 20,000 businesses, ranging in size from a mom-and-pop to TJX, the largest based on total revenues. Profit margins are slim, valued at \$100 billion in annual sales, with profits slightly above \$3 billion and a growth rate of less than 2.5 percent. Top competitors in the industry include TJX Companies, Ross Stores, L Brands, Gap, Cato, Stein Mart, and many more, including Walmart, Target, Belk, Kenneth Cole, Abercrombie & Fitch, and J. C. Penney. Notable newcomers to the U.S. market include H&M, based in Sweden and popular throughout Europe specializing in inexpensive but quality clothing. Also, Zara, a fashionable clothing store with inexpensive prices based in Spain, now has stores in the United States.

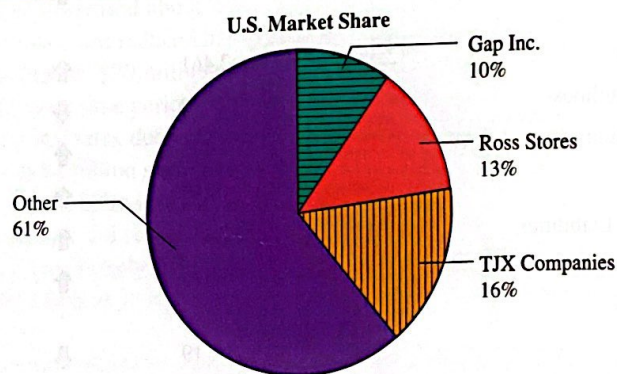
Exhibit 9 provides a financial comparison of some leading competitors in the family clothing industry. Exhibit 10 reveals the U.S. market share of family clothing stores—TJX, Ross, and The Gap Inc., account for the largest revenues.

EXHIBIT 9 A Financial Comparison of Gap Inc. with TJX and Ross (July 1, 2017 data)

	The Gap Inc.	TJX	Ross
\$ Market Cap.	13.4B	48.3B	30.6B
# Employees	135K	235K	79K
\$ Revenue	15.5B	33.2B	12.8B
% Gross Margin	36.3%	30.0%	28.7%
\$ Net Income	676M	2,247M	1,118M
EPS Ratio	2.17	3.70	3.13
P/E Ratio	15.88	20.60	25.60

Source: Based on a variety of sources.

EXHIBIT 10 U.S. Market Share Information for Family Clothing Companies



Source: Based on a variety of sources.

The TJX Companies (TJX)

A treasure hunt in a department store? This is the experience that CEO Carol Meyrowitz of TJX wants customers to have when they come into any of the company’s more than 3,200 stores in United States, Canada, and Europe. TJX is a huge retail conglomerate of off-price brands, including T.J. Maxx, Marshalls, and HomeGoods—with stores in all 50 states in the United States, 10 provinces of Canada, United Kingdom, Ireland, Germany, Poland, and in Europe. Approximately 75 percent of revenues are derived from the United States and approximately 25 percent of sales are derived from home goods. Headquartered in Framingham, Massachusetts, TJX’s revenue increased to \$33 billion in fiscal 2016 that ended January 28, 2017 up from \$31 billion, while the company’s net income remained at \$2.3 billion. Interestingly, net income for TJX has been stable with no real growth in the last 4 years. In 3,812 stores, TJX has about 235,000 employees who often work “just a few doors down” from rival companies such as Ross Stores, Stein Mart, Gap, and Cato. TJX’s largest customer group are women; the firm has a female CEO, the same as rival Gap Inc.

Ross Stores (ROST)

Based in Dublin, California, Ross Stores is a discount clothing and home fashions store offering products at prices generally 20 to 60 percent off typical retail department store prices. The firm’s main slogan is Ross, Dress for Less. The company operates under two segments, 1) Ross, Dress for Less and 2) dd’s Discounts, employs over 78,000, and reported revenues over \$12.8 billion in fiscal year end January 2017. In total, Ross operates over 1,412 stores in 37 states with product offerings similar to TJX that include women’s clothing, lingerie, maternity clothing, shoes, accessories, handbags, watches, jewelry, luggage, and more. Ross operates under a no-frills

policy that extends to having no window displays, no mannequins or other fancy marketing and advertising displays. The primary age groups for the store are 25 to 54 year olds. The company increased its store count by 87 stores in the most recent fiscal year, amounting to a 6 percent increase, which is in line with the increases in the last several years.

Online

Consumers are increasingly shopping online for clothing through auctions and online-only stores. Traditional retailers have virtually all responded with their own online websites, yet often at the same high prices found in their stores. Brick and mortar stores still hold the distinct advantage of customers being able to hold, feel, and try on items before purchasing, as well as talk to knowledgeable salespeople at higher quality stores.

Twenty of the most popular online clothing stores that compete with Gap Inc. by offering inexpensive clothing, mainly for women, are listed as follows:

1. Boohoo—a UK-based company; dresses start at \$6; free shipping on orders over \$60
2. Cotton On—an Australian retailer; dresses start at \$10; free shipping on orders over \$55
3. One Loved Babe—an online boutique for women; dresses start at \$20; free shipping
4. Yes Style—a Hong Kong-based store; dresses start at \$3.95, free shipping on orders over \$35
5. Amazon.com—Prime members get free shipping and returns
6. Missguided—a UK-based firm; dresses start at \$6; shipping free is \$5 on all orders
7. ASOS—very fast and reliable; dresses start at \$12.50; free shipping on orders over \$40
8. Adore Me—specializes in lingerie in straight and plus sizes; free shipping
9. Saved by the Dress—Miami-based; dresses start at \$25; free shipping on orders over \$60
10. Dog Dog—dresses start at \$17.95; free shipping on all orders
11. Lulu's—dresses start at \$14; free shipping on orders over \$50
12. Dress Up—boutiques; dresses start at \$16; free shipping on orders over \$50
13. Thred Up—a resale store carrying all brands like new; free shipping on orders over \$79
14. Blame Betty—offers vintage or retro clothing; dresses start at \$27.60; shipping costs vary
15. 6pm—carries many brands such as Columbia, Under Armour, Prana; for men and women
16. Nordstrom Rack—dresses start at \$6.08; free shipping on orders over \$90
17. Charming Charlie—dresses start at \$19; free shipping on orders over \$50
18. Old Navy—dresses start at \$12; free shipping on orders over \$50
19. Hollister—mainly for teens; dresses start at \$20; free shipping on orders over \$50
20. TJ Maxx—dresses start at \$7.99; free shipping on orders over \$89

External Issues

The family clothing business is very competitive as consumers increasingly have many options and many mediums to buy products. Many customers have been trained to wait for sales resulting in lower inventory turnover times and reduced profit margins for retailers. Unlike many industries such as automobiles, electronics, or restaurants, the retail clothing business is highly seasonal in nature as styles, colors, and temperatures drastically affect stocking, allocating, and marketing various merchandise. Customer tastes can change quickly as well, with one year's hot color or style of cut being less desired the next year. In the United States alone, family clothing stores account for over \$100 billion in revenue, but yield profits less than \$5 billion and a stagnate growth rate of around 1 percent. It is simply a tough business. Women's clothing accounts for 52 percent of industry revenues; men and children account for 28 and 20 percent, respectively.

Reshoring

Over the last 50 years, production of apparel (textile industry) moved from the northern United States to the southern states, then to Mexico, and from there to places in Asia, such as China and Vietnam. However, there is a growing trend, according to the Boston Consulting Group, to produce products domestically. Increasing transportation cost, government incentives, being closer to the end consumer, increasing labor cost abroad, recent changes to tax laws, and just simply being able to have "Made in the USA" on your product, is driving some firms to start production

again in the United States. Several apparel firms who are now producing some of their brands in the U.S. include Abercrombie & Fitch, J. Crew, and Ralph Lauren's Club Monaco brand. Even Nike, plagued by its operations in sweatshops in the past, is seriously considering reshoring select products.

Expenses

The family clothing store industry's profit margin is less than 5 percent with purchases accounting for 60 percent of all expenses, putting further pressure on finding cheap sources of clothing manufacturing. In 2017, over 80 percent of clothes sold in family clothing stores in the United States were imported from overseas. Also, contributing to the higher purchasing percentage is the price of cotton, which can vary wildly from year to year. Wages paid to store employees account for just over 10 percent of industry revenues and there are constant pressures to increase wages. Rent and utilities account for 6 percent and advertising and marketing only account for 2 percent of revenues.

Clothing Materials Sustainability

Many different materials are used to construct clothing. Cotton and linen are derived from plants, whereas wool, leather, and cashmere are derived from animals; today there are a slew of synthetic fibers such as polyester and spandex along with rayon, modal, and many others from wood. Cotton cultivation can leave a substantial economic footprint as pest and weed control measures, along with providing adequate water, are necessary to ensure growth. Two advantages to cotton are old clothing can be recycled and used again; Additionally, cotton is a renewable resource, or in other words, is able to be planted annually. Synthetic materials typically are nonrenewable—being derived from petroleum by products and have much longer biodegradable times than cotton. Cellulosic fibers from wood such as rayon and modal are often difficult to trace where the wood products were derived from, and at times, wood pulp is derived from endangered forests.

Future

In fiscal year 2018, The Gap Inc. plans to open about 25 additional company-operated stores, net of closures and repositions, with particular emphasis on opening new Athleta and Old Navy stores, with closing poorly performing Gap and Banana Republic stores. The company needs a clear strategic plan to best manage its thousands of brick-and-mortar stores in the face of rapidly increasing online preferences. The company hopes to maintain, or increase, its fiscal 2017 operating margin of 9.3 percent—compared with 7.7 percent the prior year. The company's products are available for purchase in more than 90 countries through company-owned, franchisee-owned, and e-commerce sites. Prepare an effective three year strategic plan for The Gap Inc.