Gap Inc.

Supply Chain Analysis

Case Report

Prof. Dr. Rizwan Raheem Ahmed

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Executive Summary

Supply chain management is the coordination of planning, making, distributing, and returning of different work processes. The process is an elaboration of the same in the context of Gap Inc. and its related brands: Old Navy, Gap, Banana Republic, and Forth and Towne.

The supply chain at Gap Inc. starts at the design and merchandising phase where designers and merchants develop product assortments and patternmakers create samples. The next phase is of planning and sourcing where specialists determine quantities to order, and factories are selected to manufacture garments. The 3rd stage in the cycle is of production and marketing where factories produce samples and the company approves the fit after which production begins. The marketing teams review samples to develop marketing strategies. Thereafter, distribution takes place where the merchandise is sent to Gap Inc.'s distribution centers where audits are performed, the products are inventories and designated for particular stores, then shipped to the stores. The final stage in the cycle is of sales and analysis where the visual merchandising team determines the floor set-up for the products. Company planners and distribution analysts review stores' sales data for replenishment and assessment purposes.

The whole cycle lasts about a year at Gap Inc. however, after seeing sales decline for a while in recent years, Gap realized that it had to do something to minimize it in order to remain competitive. Each link on the supply chain is manned with effective leaders and managers so as to maintain smooth flows within the system and report if there are any problems that require addressing by the top leadership. The solutions can range from capital expenditures to divestitures, depending on the nature of solutions required. With this report, we have tried to longitudinally and lattitudinally dissects the supply chain of Gap Inc. and tried to conclude the different turns it took at each point where its corporate strategy took a new turn. This helped us appreciate the importance of sound supply chain management that can determine the soundness with which corporate and business level strategies can be set and further shapes.

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Company Introduction

Donald and Doris Fischer opened the first Gap store in San Francisco, CA in the year 1969. The store was named after the "generation gap", and the first stores catered almost exclusively to teenagers and mainly sold Levi's jeans. One store grew to six by 1970, and in 1976, shares of The Gap went public, becoming **Gap Inc.** During the 1970's and the early 80's The Gap remained dependent on its appeal to teenagers, but did attempt to move away from it's reliance on the sale of Levi's by introducing private labels in their stores. By the early 80's, there were 500 Gap stores in the U.S.

1983 was a turning point for **Gap Inc.** One event of major significance was the hiring of Mickey Drexler, former Ann Taylor president, as the president of **Gap Inc.** Mr. Drexler revamped the company's clothing lines to focus on bright, well-made cotton clothing, and he consolidated all the private labels in Gap stores under the Gap name. Additionally, Levi's were gradually phased out, and by 1991;**Gap Inc.** only sold private label items.

Also in 1983, **Gap Inc.** acquired Banana Republic, which was then a two-store enterprise that sold safari clothing. Under **Gap Inc.**, Banana Republic expanded rapidly, and was extremely profitable for a time in the mid 80's until the fad of jungle-themed clothing wore thin. The innovative Drexler revamped Banana Republic, dumping the safari clothing in 1988 and introducing a wider variety of nicer, more expensive clothing lines to sell in the stores. Through these changes, Banana Republic returned to the black in 1990.

Gap Kids, founded in 1985, came about after Mr. Drexler could not find any clothes he liked for his son. The baby Gap line soon followed, with the first clothes from this line being sold in 1990. These divisions of The Gap were a result of Mr. Drexler's vision of making The Gap a "life" brand, providing comfortable clothing for all ages, from newborn to adult. Besides expanding its clothing lines, The Gap also expanded internationally, opening its first stores outside the U.S. in 1987. By 1993, the Gap had stores in England, France and Canada.

Gap Inc. experienced some trouble in 1993, as earnings fell due to a combination of higher rents and slimmer profit margins. In response to this, a management shuffle occurred, and **Gap Inc.** focused on improving profit margins, rather than simply increasing sales. The company rebounded in 1994 through these changes and through the strong performance of the new Old Navy brand. The Old Navy brand (named by Drexler after a bar he saw in Paris) debuted in 1994, and focused on providing quality-clothing basics at a good value.

However, the Gap line of stores was still experiencing declines in sales. As a result, Robert Fisher (son of founder Donald Fisher) became president of the Gap division in 1997. Mr. Fisher refocused the division's theme on T-shirts, jeans and khakis while implementing the first stages of Gap's catchy marketing campaign. However, sales once again became sluggish in 1999, and Mr. Fisher resigned, with now-CEO Drexler taking over responsibility for the Gap line.

The entire family of **Gap Inc.** stores suffered a major setback in 2000, through a combination of miscalculating fashion trends and straying from their product themes. As a result, **Gap Inc.** returned disappointing earnings through 2002, which resulted in their stock price losing over 2/3 its value. Debts rose significantly during this period, while inventory management was poor. International sales were especially poor. Because of this, The Gap split operations into Gap and Gap international in order to turn around the division's poor performance.

As a result of all this turmoil, CEO Mickey Drexler retired in late 2002 and was replaced by Paul Pressler, formerly of the Walt Disney Company. **Gap Inc.**'s focus since 2002 has been to return back to the clothing themes that made each brand (Old Navy, Gap, and Banana Republic) successful, and to streamline the company's operations. The workforce was cut by 10%, and several international stores were sold to foreign retailers.

At this time, **Gap Inc.** working at continuing its rebound from their missteps in 2000-2001 through improving margins and reducing their outstanding debt. Gap Inc. is also planning on introducing a new chain of stores catering to women over 35, and may introduce a new line of maternity clothing. By staying on top of fashion trends and maintaining a consistent, unique message through their brands, **Gap Inc.**'s prospects may once again be bright.

Case Abstract

When Don Fisher founded Gap, little did he know that he would be transforming the face of retailing supply chain forever, He is said to have admitted that he never imagined the store to grow beyond 'a modest chain of casual apparel stores.' Known to operate on the mantra "change or fail", Mr. Don Fisher was competitive as he was compassionate. Today the store serves customers globally through its 3,500 stores and 135,000 employees. "Don always spoke passionately about building quality and value…"

Gap Inc. is an umbrella brand for Gap, Old Navy, Banana Republic, Gap Kids, Gap International, and Forth and Towne. Gap being the mother ship of the company is considered among mid-price brands such as Limited Brands. The store was named after the "Generation Gap" because jeans had emerged as the youngster's uniform. Gap caught onto the idea of selling jeans early on and tried to cater to the heavy demand while other retailers were still scrambling to make sense of what had hit them.

US apparel market continually demand fashionable new products, yet it often take many years for most companies to bring new products to market. Most apparel production, even today, is typically planned far in advance, based on highly speculative forecasts. Long lead-times, distances and hand-offs between members of the supply chain create tremendous losses for retailers due to markdowns, stock-outs, high inventory levels and shrinkage. In an effort to mitigate these losses, the players in this industry have tried to shift risk either back to the suppliers or forward to their customers. Shorten design, development, Production & distribution Cycles are the New dimensions in Supply Chain Management: A Case Study of GAP New trends & Competitive advantages of GAP Inc.

This report analyses the competitive edge that the supply chain of Gap Inc. lent to the building of its brand In the past, retail stores often carried apparel products months in advance of the season in which they would be worn. Times have changed, however, and consumers nowadays tend to buy closer to need. To meet this demand, manufacturers have had to shorten design, – development, production, and distribution cycles.

This report also present how apparel industry leaders have made changes to their purchasing practices – and even their corporate structures – in continued efforts to improve working conditions in factories and to reap the benefits of having an effectively managed supply chain through changes in corporate culture, designing and buying, forecasting, production management, and pricing.

The main focus of Gap around the time of founding had been Levi's jeans and (music) records. The company was founded on the basis of straightening the supply chain by providing "all possible available sizes of Levi's jeans under one roof". Eventually the company transformed into becoming a main provider of basic clothing items like its own line of jeans, khakis, button-down shirts, chinos, and tee shirts.

Specialty clothing retailers accounted for 30% of total apparel sales in 2004[1]. Gap Inc. had the largest marketing share of this group, 31.4% after a few years of declining sales, the company, as well as the industry, as part of a sales revival strategy, decided to conduct in USA in 2003. This study on human anthropometrics was conducted to gauge the most recent body sizes of the population as a result of the changing American body size. This had direct ramifications on better inventory management as the study enabled retailers to offer better-fitting merchandise. It is also known that studying demographic trends helps add predictability to the system- it is like a combination of information and inventory systems management within the supply chain.

Gap Inc. has had a history of keeping track of shifting demographics as a way to shape up its corporate and business level strategies. Its discovery of the baby boomers delayed retirement plans enabled it identify demand for older adults requiring work-appropriate clothes. Gap was part of the specialty clothing retailers that followed the department store crazy following World War II. However, discount and specialty clothing, of which Gap and Old Navy were a part of, had started giving these huge, commercial centers of shopping a run for their money. In 2005, the largest chain of department stores, Federated Department Stores, was headed for consolidation through acquisition. As well, discount retailers operating on the mass channel started adding fashionable items to their clothing lines in recent years and that was a great boon

[1] Gap Inc., "Gap Inc. Reports First Quarter Earnings," (2005) Gap Inc. Website (2010)

to the success of specialty retailing. This fight for market shares was combated with strategic alliances, partnerships and the resulting additions to the supply chains of some companies.

Another factor that was keeping Gap Inc. at on its toes was the fast-fashion business model pioneered by Spain's Zara and Sweden's Hennes & Mauritz (H&M). This was revolutionizing the sector, and other high-fashion retailers had to keep up with fast inventory turnover or risk losing market share to high fashion consumers. This fast movement in supply chain was fast becoming the norm and retailers that wanted to remain competitive had to keep up with the changing tide in retailing. The fast-fashion model was notorious for its tight communication among shoppers, store managers, designers, production staff, and distributors so it could regularly create and rapidly replenish small batches of new goods. It managed all design, warehousing, distribution, and logistics function itself and even produced half of its own merchandise, enabling it to rhythmically order all steps in the supply chain. As well, it made capital investments that allowed it vertical integration the chain's flexibility. Such inventory decisions as stocking lesser units so as to be able to turn it over fast are part of an overall strategy of exclusivity and scarcity, thus encouraging full price purchases. Therefore, it can be concluded that it is not supply chain decisions that are made first, but the kind of corporate strategy that will dictate inventory, information, production, location, transportation decisions. New collections were thereafter added to the stores every 6-8 weeks.

There are other external variables, known as microeconomic variables that determine the prevailing factor conditions in the environment in which a business is to operate. The WTO quota system for example had an effect on the way Gap Inc. conducts business. During the quota era, 70% of Gap merchandise was subject to quotas, whereas prices dropped as the phase-out of the agreement began in 1994.

Another example of macroeconomics variables affecting the supply chain of Gap Inc. was the change in Federal Trade Commission laws in 1976 that manufacturers could no longer set prices. This enabled Gap to sell Levi's jeans at discounted prices, which was previously disallowed by the supplier, and also allowed Gap to add more brands (and suppliers as a result) to its supply chain. Within time, Fisher (the founder) hired a president from another large clothier to manage operations. Within time, Gap became more vertically integrated, stepped up its design function, and refocused the company efforts in selling basic, casual apparel. This goes to show the effect

of a change in leadership and its vision and its subsequent effect on the supply chain. This is mostly by way of modification to the corporate vision and its related strategy. As an extension to the same observation, adding brands to a main brand allows a company to become more versatile and respond to shifting demand. This expands the supply chain as a result and leaves the company to decide how it wants to pursue its strategy in accordance with its available resources.

The early 1990's lent further advantage to the company in the form of a recession in the economy. The company was able to bag a few good deals in terms of planting itself in the middle of towns and urban neighborhoods. This inevitably increased sales and allowed the company to expand the base of its supply chain and increase profitability as a result. Thereafter, as part of the corporate philosophy of ensuring top-notch quality, the company installed over 200 quality inspectors working inside factories in 40 countries, making the supply chain even more complex and furthering the cause of the company further.

As part of a corporate strategy, CEO Drexler in 1994 added a third brand to the portfolio of Gap Inc. that it called 'Old Navy'. The inspiration for the name was derived from a bar he once visited in a foreign land. This vision translated into the supply chain being expanded once again. As well, the dot com bubble dictated the company to add business casual clothing that gave rise to the trend of khakis, which were also promoted very heavily. Subsequent bad decisions in the face of changing market dynamics also compelled the company to revise its supply chain, expanding in some parts, and chopping of others.

The different brands within the umbrella of Gap Inc. can be seen as the different ends to the supply chain: Gap, Banana Republic, and Old Navy, had centralized buying and logistics functions, but separate design, merchandising, marketing, and retailing functions. The addition of further brands therefore can be seen as expanding the end of the funnel and perhaps thicker links in the supply chain. Further, style decisions and new product offerings can also be seen to be dictating the supply chain and how it should be designed.

When leadership shifted from CEO Drexler to Pressler, who was more research oriented, he let the research findings dictate trend that further dictated requirements and expansion in the supply chain. As well, his decision to empower general managers and the store designers, as well as letting the VP of Gap brand store experience set the tone for how customers should perceive the

store also affected the supply chain. Giving a good store experience as was the mantra of the VP had an effect on store design options and how things are done- ultimately resulting in changes in the supply chain.

CEO Pressler also acknowledges challenges in selling Gap abroad in the likes of Germany and after a dismal run for 10 years, made the hard decision to sell out and wind up from there. These lackluster sales compelled him to make conscious choices about the supply chain modification and directed planning to localize sizing and merchandise abroad in future. Thereafter, he decided to man each sensitive point in the supply chain with a capable leader to make effective decisions in a timely manner.

The brand positioning for each of the different brands of Gap Inc., such as Banana Republic, Forth and Towne etc., matters to how the supply chain is designed. The differentiating factors in product planning, execution, design, production, and marketing are essentially the sum of differences in the supply chain as well. The market dynamics dictate target markets that have an effect on target markets, that determine corporate and business strategies that ultimately determine how the supply chain will be set. It is not but a deliberate attempt at setting up a supply chain, but a design that is largely dictated by the overall strategy of the firm.

When Old Navy was being set up, it was again the positioning of the brand that dictated how the existing supply chain of Gap Inc. would be expanded and built upon, so as to respond to market demand and earn additional profitability. In sum, the different parts of a supply chain are not disparate elements that just magically come together to function as a support function for the philosophy of the company. It is up to the company how it wants to go about designing systems and networks to achieve its mission, aims, and objectives, and use the existing network in its supply chain for expansion or addition to its product portfolio. To sustain a supply chain, you need marketing efforts in the face of different macroeconomic variables and vice versa. Said another way, it boils down to mixing and matching supply chain alterations with marketing efforts in the context of prevailing factor conditions in the economy.

Introduction To Supply Chain Management

Supply chain management (SCM) is the coordination of a network of facilities and distribution options that performs procurement of materials, processing the materials into finished products, and distribution of the products to customers. SCM is seen as involving five core processes. These include planning, sourcing, making, delivering, and returning.

Some Definitions of SCM

"A supply chain is the alignment of firms that bring products or services to market."—from Lambert, Stock, and Ellram in their book *Fundamentals of Logistics Management* (Lambert, Douglas M., James R. Stock, and Lisa M. Ellram, 1998, *Fundamentals of Logistics Management*, Boston, MA: Irwin/McGraw-Hill, Chapter 14)

"A supply chain is a network of facilities and distribution options that performs the functions of procurement of materials, transformation of these materials into intermediate and finished products, and the distribution of these finished products to customers."—from Ganeshan and Harrison at Penn State University in their article *An Introduction to Supply Chain Management* published athttp://silmaril.smeal.psu.edu/supply_chain_intro.html (Ganeshan, Ram, and Terry P. Harrison, 1995,"An Introduction to Supply Chain Management," Department of Management Sciences and Information Systems, 303 Beam Business Building, Penn State University, University Park, PA).

If this is what a supply chain is then we can define supply chain management as the things we do to influence the behavior of the supply chain and get the results we want. Some definitions of supply chain management are: The systemic, strategic coordination of the traditional business functions and the tactics across these business functions within a particular company and across businesses within the supply chain, for the purposes of improving the long-term performance of the individual companies and the supply chains a whole."—from Mentzer, DeWitt, Deebler, Min, Nix, Smith, and Zacharia in their article *Defining Supply Chain Management* in the *Journal of Business Logistics* (Mentzer, John T.,William DeWitt, James S. Keebler, Soonhong Min,

Nancy W. Nix, Carlo D. Smith, and Zach G. Zacharia, 2001, “Defining Supply Chain Management,” *Journal of Business Logistics*, Vol. 22, No. 2, p. 18).

Difference between Supply Chain Management & Logistic

There is a difference between the concept of supply chain management and the traditional concept of logistics. Logistics typically refers to activities that occur within the boundaries of a single organization and supply chains refer to networks of companies that work together and coordinate their actions to deliver a product to market. Also traditional logistics focuses its attention on activities such as procurement, distribution, maintenance, and inventory management. Supply chain management acknowledges all of traditional logistics and also includes activities such as marketing, new product development, finance, and customer service.

In the wider view of supply chain thinking, these additional activities are now seen as part of the work needed to fulfill customer requests. Supply chain management views the supply chain and the organizations in it as a single entity. It brings a systems approach to understanding and managing the different activities needed to coordinate the flow of products and services to best serve the ultimate customer. This systems approach provides the framework in which to best respond to business requirements that otherwise would seem to be in conflict with each other. Taken individually, different supply chain requirements often have conflicting needs. For instance, the requirement of maintaining high levels of customer service calls for maintaining high levels of inventory, but then the requirement to operate efficiently calls for reducing inventory levels. It is only when these requirements are seen together as parts of a larger picture that ways can be found to effectively balance their different demands.

Effective Supply Chain Management

Effective supply chain management requires simultaneous improvements in both customer service levels and the internal operating efficiencies of the companies in the supply chain. Customer service at its most basic level means consistently high order fill rates, high on-time delivery rates, and a very low rate of products returned by customers for whatever reason.

Internal efficiency for organizations in a supply chain means that these organizations get an attractive rate of return on their investments in inventory and other assets and that they find ways to lower their operating and sales expenses. There is a basic pattern to the practice of supply chain management. Each supply chain has its own unique set of market demands and operating challenges and yet the issues remain essentially the same in every case. Companies in any supply chain must make decisions individually and collectively regarding their actions in five areas:

1. Production—what products does the market want? How much of which products should be produced and by when? This activity includes the creation of master production schedules that take into account plant capacities, workload balancing, quality control, and equipment maintenance.

2. Inventory—what inventory should be stocked at each stage in a supply chain? How much inventory should be held as raw materials, semi finished, or finished goods? The primary purpose of inventory is to act as a buffer against uncertainty in the supply chain. However, holding inventory can be expensive, so what are the optimal inventory levels and reorder points?

3. Location—where should facilities for production and inventory storage be located? Where are the most cost efficient locations for production and for storage of inventory? Should existing facilities be used or new ones built? Once these decisions are made they determine the possible paths available for product to flow through for delivery to the final consumer.

4. Transportation—how should inventory be moved from one supply chain location to another? Airfreight and truck delivery are generally fast and reliable but they are expensive. Shipping by sea or rail is much less expensive but usually involves longer transit times and more uncertainty. Stocking higher levels of inventory must compensate for this uncertainty. When is it better to use which mode of transportation?

5. Information—how much data should be collected and how much information should be shared? Timely and accurate information holds the promise of better coordination and better

decision-making. With good information, people can make effective decisions about what to produce and how much, about where to locate inventory and how best to transport it.

The sum of these decisions will define the capabilities and effectiveness of a company's supply chain. The things a company can do and the ways that it can compete in its markets are all very much dependent on the effectiveness of its supply chain. If a company's strategy is to serve a mass market and compete on the basis of price, it had better have a supply chain that is optimized for low cost. If a company's strategy is to serve a market segment and compete on the basis of customer service and convenience, it had better have a supply chain optimized for responsiveness. Who a company is and what it can do is shaped by its supply chain and by the markets it serves.

The Supply Chain

SCM exists in both service and manufacturing environments. A typical supply chain consists of many interactions between suppliers, manufacturers, distributors, retailers, with the ultimate goal of providing either a service or a product to customers. This also works in reverse with the customer at the head of the process when returning a product. SCM is used as a means to integrate planning, purchasing, manufacturing, distribution, and marketing organizations that normally do not work together to achieve a common goal. Each works toward goals specific to their own organization that accomplish narrow objectives. SCM is a way of integrating these varying functions so that they work together to maximize the benefits for all involved.

Levels Of Supply Chain Management

There are three levels of SCM: strategic, tactical, and operational.

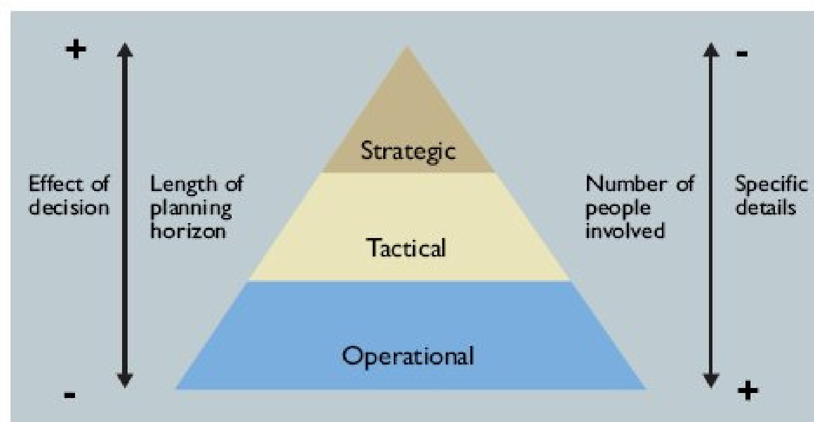

Fig 2: Three Levels of SCM *[Source: Auto-ID: Managing Anything, Anywhere, Anytime in the Supply Chain, Bose and Pal, ACM August 2005]*

Strategic Level

Strategic SCM deals with future planning than in looking at market evaluation, capacity issues, new products, and technology changes. This planning is addressing issues that may be factors several years out. This is accomplished at the executive management level.

Tactical Level

Tactical SCM involves a shorter planning cycle. It is more concerned demand planning, inventory planning, and supply planning. This is determined at a less senior level than Strategic SCM.

Operational Level

Operational SCM is current planning activities measured in at most weeks. Operational SCM involves the majority of the operations. It includes demand fulfillment, scheduling, production, transport, and monitoring.

Decisions To Make

There are many decisions that are made when looking at SCM. They follow the above categories. Strategic decisions are made over longer periods of time and linked to a corporation's strategy. Operational decisions are more short term and look at day-to-day activities. Four major decisions are considered. They include decisions on location, production, inventory, and transportation. A geographically strategic placement of the production facilities is key to creating a successful supply chain. Decisions on what products to be produced have to be made wisely and strategically. Also, where these products (locations) will be manufactured is very important to SCM. Inventory decisions and management is critical. Some inventories are necessary to hedge against uncertainty, but this comes with a cost. Managing these inventories efficiently will be of benefit to the corporation. Transportation decisions include cost versus benefit. Air transportation is costly, but fast and reliable. Other modes of transportation may be cheaper, but the sacrifice has to hold inventories due to delays that may occur. If the above decisions are made with careful and strategic thought as well as with concern for integration, the supply chain should be efficient and successful.

Pitfalls in Supply Chain Management

No Supply Chain Metrics:

In a supply chain with multiple sites, each site will often have its fairly autonomous management team. The objectives of the various teams may differ, and even be conflicting. Inventory may for example be reduced at a Site A of a supply chain, and thereby, seen from a local perspective, the performance is enhanced. But the inventory decrease may also decrease Site A's flexibility Because Site A now responds more slowly to changes, Site B, which is Site A's customer will have to increase its inventory (of Site A parts) in order to maintain its flexibility and level of customer service. The lack of supply chain metrics has prevented managers at Site A to see that their local improvements has not lead to improved overall performance of the supply chain. The objective of supply chain metrics is to give the basis for evaluations of the performance of the whole supply chain as one system.

Inadequate Definition of Customer Service:

Too few and in concise metrics for customer service. The evaluation of performance becomes difficult, and certain aspects of customer service may be overlooked.

Inaccurate Delivery Status Data:

Customers are not correctly informed of delivery dates of orders and of late deliveries. Companies can often not readily retrieve the information needed to do so.

Inefficient Information Systems:

Databases at different operation sites that describe system environment, inventories, backlog, future production plans, and so on are often not linked. Information must be retrieved manually, and this can be a long process. Planning cycles may therefore be long, using highly uncertain demand forecasts. The wrong products are made, and inventories and backlogs grow.

Ignoring the Impact of Uncertainties:

Too often supply chains do not track uncertainties such as suppliers' delivery times, the quality of incoming materials, manufacturing process time, transit times, and so on. This leads to non-optimal stocking levels. In some cases uncertainties are properly tracked, but there is no follow-up.

Simplistic Inventory Stocking Policies:

Stocking policies are often not linked to knowledge of the uncertainties mentioned above. Stocking policies are often based on the quantity usage of the items stocked. This says nothing about the uncertainty associated with the usage. Analysis show that stocking levels could be greatly reduced by transferring stocking policies from being quantity based to being uncertainty based.

Organizational Barriers:

Entities in a supply chain may belong to different organizations within the same company. The organizations will independently measure the performance of the entities. While each entity is occupied with achieving local goals (much like in pitfall 1), important synergies may be lost.

Incomplete Supply Chain:

Supply chain managers are often focused only on the internal supply chain. Going beyond the internal supply chain by including external suppliers and customers often exposes new opportunities for improving internal operations. Through agent-based management and information system with increased integration and coordination many of these pitfalls can be avoided.

Supply Chain Challenges And Opportunities In Apparel Industry

In the past, retail stores often carried apparel products months in advance of the season in which they would be worn. Times have changed, however, and consumers nowadays tend to buy closer to need. To meet this demand, manufacturers have had to shorten design, –development, production, and distribution cycles.US apparel market continually demand fashionable new products, yet it often take many years for most companies to bring new products to market. Most apparel production, even today, is typically planned far in advance, based on highly speculative forecasts. Long lead-times, distances and hand-offs between members of the supply chain create tremendous losses for retailers due to markdowns, stock-outs, high inventory levels and shrinkage. In an effort to mitigate these losses, the players in this industry have tried to shift risk either back to the suppliers or forward to their customers.

Competitive Analysis

Industry

Gap Inc. operates within the specialty retail apparel market, a market that contains several large direct competitors, such as American Eagle Outfitters, Abercrombie and Fitch, J. Crew and Aeropostale. Because of the nature of the fashion industry, independent specialty stores and boutiques can compete with these larger brands on a localized level. Additionally, a variety of larger retailers also compete with Gap. Department stores such as Sears, J.C Penney, T.J. Maxx, Marshalls and Macy's sell significant amounts of clothing; some of the aforementioned stores obtain a majority of their revenues from the sale of apparel.

It is worth mentioning that superstore retailers such as Target and Wal-Mart sell low-priced, lower-quality clothes, so they could also be considered as indirect competitors to Gap. Clearly, there are a large number of apparel retailers, and a smaller, though still large, number of direct competitors to Gap within the specialty retail industry. This competitive landscape lends itself to a high level of price competition.

The specialty apparel market is one, which has generally shown slow, but steady growth. Barring a major recession forcing consumers to buy no-frills clothing or an unexplained broad increase in demand for brand-name clothing, there is no obvious obstacle to continued slow growth.. As a result, in order for firms to gain market share and grow, they must take away market share from their competitors. One of the more interesting aspects about the specialty apparel market is that it is a market where buyers 'faces essentially zero switching costs. While firms try their best to differentiate their products in a way that will draw buyers of a rival brand of clothing to their brand, each brand of clothing is only superficially different from another brand. The major apparel retailers are all essentially selling articles of clothing, so it seems illogical to call them different products. However in fashion related markets seemingly trivial product characteristics are of great importance to consumers. Differences in style create brand preferences among consumers. Jeans are jeans, but to a consumer a pair of jeans from the Gap and a pair from Abercrombie & Fitch are two distinct goods, and a buyer will be willing to pay different prices for each. Competition, therefore, arises in fashion. Firms want to appeal to as many consumers as possible while keeping those already loyal to the brand happy with the style of clothes the firm

offers. The winning style maintains the brand loyal customers association with the firm's image, while attracting new buyers. A mistake in fashion, however, will lead some loyal customers to abandon their brand, and will fail to attract new customers.

Each Gap brand caters to a variety of consumers, with some overlap. However, each brand has a target market and specific methodology for acquiring consumers. Examining each brand with regards to these factors will give a much better picture of the competitive landscape.

The Old Navy brand targets the lower middle-to-middle income consumer, overlapping to some extent the target market of the Gap brand as well. The target demographic are moms and dads, and to a lesser extent, young adults and teens. Old Navy stores are generally the largest of the three Gap brands; additionally, the stores are often standalone, outside-the-mall units. For comparison, Old Navy has 843 stores with 16.8 million square feet, while Gap has 2,273 stores with only 13.0 million square feet. The selling points of Old Navy are fashionable, quality clothing at low prices. Because it's a brand, which uses price as a selling point, larger retailers such as Target and Wal-Mart along with department stores compete with Old Navy. Often, Old Navy stores are located next to or nearby these types of stores. Conversely, they also compete with more fashion-oriented brands like Aeropostale, although these stores are more often mentioned as competitors with the Gap brand. Against these brands, Old Navy competes for customers by providing lower prices.

Gap has the broadest customer base, and a target consumer is difficult to define. The Gap consumer ranges from lower middle to upper-middle income, the former for quality items and the latter for fashion basics. The majority of sales are to adults between 18 and 35, but consumers range from babies to baby boomers.

Gap stores are generally found in malls and shopping plazas, with the occasional standalone store. Within the malls, Gap stores are larger than the typical mall store, taking up two or three units to accommodate the numerous Gap divisions(Gap kids, baby Gap, Gap Body, plus the male and female divisions). Marketing is key for Gap, as they compete with a large number of firms,

and it is imperative to differentiate themselves from the crowd. These competitors include American Eagle, Abercrombie & Fitch, Ann Taylor, Express, and Eddie Bauer.

Banana Republic represents the most pricey and fashion-conscious of the Gap brands. Its target consumer is generally 25-35 years old, is willing to pay a premium for style, and lives in or near a metropolitan area. The fashions available in store are targeted for both fashion-forward and fashion-follower consumers. One of the most important selling points of Banana Republic is the shopping experience. Management recently focused on providing better customer service and longer training periods for new employees in order to foster emotional connections with the consumer. Additionally, Banana Republic has implemented some frequent shopper incentive programs. Banana Republic competes with Brooks Brothers, J. Crew, Ralph Lauren, Kenneth Cole and Armani, among others.

There is no cooperative pricing in the specialty apparel market. Firms price their clothing based on their target customer. Some trendier firms set higher prices for their apparel, in order to appeal to consumers interested in conspicuous consumption, a market segment that Gap targets through its Banana Republic brand. However, pricing by Gap within the brands generally follows the quality of clothing being produced and usually does not reflect a significant mark up. In any event, price competition within the specialty apparel market can be fierce, especially during seasonal sales. Given these market characteristics, not only is it crucial for Gap to continuously identify popular fashions across each of its market segments, but also it is also essential for Gap to effectively market its fashions to its target consumers.

Gap has done well in diversifying its market presence with Old Navy, The Gap, and Banana Republic. This has enabled Gap to target a wider variety of customer types than its competitors, which has lead to increased sales. As Gap has geographically saturated its markets, it appears that the extension of its brands to new customer types (maternity, women over 40, etc.) may be a solid strategy to increase sales and market share.

Substitutes and Complements

On an industry level, there is no popular substitute for clothing. Lack of an identifiable substitute for apparel keeps demand at a level consistent with the broader performance of the economy. A booming economy where individuals have more disposable income may lead them to buy more clothing. In the reverse situation, demand for new clothing will likely drop if the economy is performing poorly. Because there are no substitutes for clothing, an increase in price by one firm will cause consumers to purchase clothing from another firm. If prices rise throughout the industry, consumers will buy less clothing.

The fact that consumers essentially face zero switching costs underlines the importance of Gap maintaining the popularity of and their customers association with its different brand images. While the declining sales observed in 2001-2002 can be partially attributed to the economic downturn, poorly designed marketing campaigns that were too focused on small portions of the target market segments also seem to have been a significant cause. However, in recent years, Gap has shifted the focus of its marketing campaigns to target a broader customer base, allowing more customers to identify with its brands. For example, market research allowed Gap to better identify its target customer for the Banana Republic line, which in turn enabled Gap to market its products more efficiently. The resulting sales increases indicate that the threat of substitutability can be effectively reduced through marketing efforts that maximize customer association. Complements, including such accessories as shoes, jewelry, purses and the like exert a very minor effect on the demand for apparel. Consumers, on occasion, will buy clothing to match a pair of shoes or piece of jewelry, but such purchases are likely of little significance in the overall demand in the apparel market.

Buyer and Supplier Power

Supplier power is concentrated in the firms who supply the raw materials for clothing production and the factories that are contracted to produce them. There are many sellers in both markets, and the power they possess is limited since demanding a higher price will cause the clothing manufacturer to buy the raw materials elsewhere. For instance, Gap contracts factories in over 60

different countries; if one factory is asking too high a price to produce their clothes, Gap can take their business elsewhere. Only if a factory holds a certain expertise in producing a certain type of clothing will they hold much power over the firm selling the clothes. There is little threat of vertical integration by suppliers, since most of these suppliers are not located in the United States and there are significant barriers to entry into the domestic market. Since Gap only sells their products directly to consumers, buyers wield little, if any, direct power in this market. Prices are non-negotiable, and the fact that buyers can shop around for better prices is more a product of competition rather than buyer power.

Entry

Gap faces little threat of increases in price competition by entry of new firms into the market. Smaller boutique-style clothing stores may be able to compete on a local level with the Banana Republic brand, however such firms likely would not be able to expand, and both Gap and Old Navy enjoy a cost advantage in producing staple articles of clothing, such as jeans and sweaters. Due to economies of scale in producing large amounts of clothing, entrants will have extremely hard time producing clothing at cheap enough prices to compete with Gap and its competitors. Entrants would also have difficulty in finding supplier firms who would produce their clothing at a competitive cost level. Costs drop per unit of clothing produced, and an entering firm would need to order a large amount of clothing in order to enjoy the same economies of scale that Gap enjoys.

Brand loyalty is also important in fashion. Because many consumers have strong preferences for certain brands or styles of clothing, new entrants would find difficulty in increasing the amount of customers they attract to their stores without incurring significant advertising expenses. Because of their size advantage and economies of scale in advertising, Gap has a significant advertising advantage over all other direct competitors within the specialty apparel market. They can afford to run well-known nationwide television advertising campaigns while other firms in the market do little or no TV advertising. A new entrant trying to steal away brand loyal customers from Gap would need vast advertising resources in order to establish their brand and be competitive, which is unlikely for an emerging firm. Other than monetary considerations, the

inputs necessary in such a market are not extremely difficult to secure. Raw materials, such as fabrics and dyes are plentiful and available in bulk. Little technical expertise is necessary to produce clothing as well. The greatest difficulty facing a new firm trying to produce at a large scale would be in finding/building factories to produce the clothing cheaply. Most clothing is produced in the international market, and outsourcing production in this way through the purchase of production rights within a factory can be moderately difficult, and the initial investment would be very expensive.

The level of post-entry competition faced by a new firm entering into the specialty apparel market depends on the target market and the prices they plan to sell their product. A new firm challenging Old Navy would have a hard time competing price-wise; Old Navy prices their clothing cheap, and a new firm would find it hard to survive on the slim margins such low prices afford on an undoubtedly smaller volume of sales. If they were to try to lower their prices below that of Old Navy, brand loyalty might keep customers shopping at Old Navy anyway, while the volume of sales the new firm would attract would be too small to sustain the small profit margins. Competition from an entrant into the Gap or Banana Republic market would entail more fashion and advertising competition rather that price competition. This goes back to the brand loyalty issues the entering firm would face. As mentioned before, significant resources available for advertising and marketing would be required in order to compete at a significant level within the industry.

Role Of Purchasing In Supply Chain Management:

For the past 15 years, many apparel companies have been actively monitoring their supply chains. Throughout, the majority has looked to factory owners and managers to make changes in factory conditions and operations to comply with local laws and meet brand compliance requirements. To meet requirements, demands were placed on suppliers to increase wages, minimize excessive overtime hours, secure freedom of association, and improve health and safety systems for workers. Simultaneously, brands were dictating lower and lower prices for products. Increasing demand for products at lower prices frequently prevents suppliers from having the resources necessary to abide by the standards laid out in codes of conduct.

More recently, labor activists and socially active investors have turned to the inner workings of apparel companies to see how the companies' activities have had an impact on factory conditions. A study by Oxfam UK concluded that "until companies recognize that their own sourcing and purchasing practices are one of the root causes of poor labor standards, they will not resolve the problems in their supply chains. "In addition, improving purchasing practices not only minimizes compliance violations but also saves companies on their total costs of bringing a product to market, moves a product to market faster, improves quality and prevents burn out.

This report present how apparel industry leaders have made changes to their purchasing practices – and even their corporate structures – in continued efforts to improve working conditions in factories and to reap the benefits of having an effectively managed supply chain. We look at changes in corporate culture, designing and buying, forecasting, production management, and pricing.

Corporate Culture

Leaders in the apparel industry recognized that if compliance is a division unto itself, then it functions alone. Integrating corporate responsibility and sustainability throughout the supply chain, instead of as a separate "add-on" has significant impacts on compliance and cost-savings. Linking factory performance to headquarter staff's annual reviews, and training management and staff on compliance issues further integrates responsible practices into corporate culture.
Gap Inc. has begun to tie factory compliance to performance of production personnel at the Vice President and above levels.

In order to evaluate corporate staff and management on compliance issues, training is necessary. Staff must understand the "bigger picture" of the true and total cost of bringing goods to market.
To enhance training within the brands, **Gap Inc.** is using simulations in which trainees "have to make decisions and see the impact of the downstream affects of their decisions." These trainings are offered to new hires and in the development of new managers.

Designers and Buyers

Designers and Buyers are responsible for one of the most dramatic causes of compliance violations –last minute changes to either the design or quantity of an item. The last-minute nature of their decisions is intricately related to the essence of fashion. The need to be on the cutting-edge pushes designers and buyers to want to make changes to designs, trims, quantities, and colors as close to market as possible in order to respond to the latest trends.

Designers

Designers at **Gap Inc.** and other companies are "in the market looking at what is going to be the next big thing and building products based on those inputs." In order to avoid last-minute design changes, **Gap Inc.** has created an "orchestrated dance where every day is mapped with the tasks to bring the product to market. The design team works within the calendar. There is a checklist of who does what and when. The designers are familiar with the vendor base and its capabilities. The production team sits with them and educates and guides them from the standpoint of 'yes, you want to make this sweater, but we can only make it for December, not November'." By implementing this element of production capability into the design process, designers are not creating pieces that cannot be produced within a reasonable schedule.

Buyers

The two primary areas where buying decisions have an impact on compliance are initial sourcing decisions and last minute changes. Supplier reviews help to both inform buyers of factory capacity and identify order patterns that have a negative impact on compliance. **Gap Inc.** found that in pre-screening factories "most capacity analysis is focused on quantity, not capability" and that both need to be taken into account. To help avoid overbooking factory capacity when a number of **Gap Inc.**'s brands are sourcing from the same factory, the company noted that "it had recently developed a tool that should help it gain better visibility across multiple business units

to its total sourcing picture with a vendor. That visibility will help facilitate coordination so that vendor can better manage its production."

All of the above practices inform buyers' initial sourcing decisions from factories and facilitate those orders being executed in a timely, high-quality fashion. Another practice buyers can modify to improve purchasing practices is last-minute changes. Last-minute changes shorten the available manufacturing production time and force suppliers into an often-untenable situation because they want to meet the needs of the brands, but have limited time to do so. As a result, there is a risk that workers could be forced to work excessive overtime to meet deadlines and not receive an overtime premium because the buyer wants the change for no additional charge, even if this violates the vendor agreements. To reduce these strains on suppliers, **Gap Inc.** is implementing a new "social responsibility training to all production, sourcing, and merchant teams where we focus on how to make decisions better and differently that affect the workers in a positive way."

Forecasting

Some of the challenge for buyers is a function of the accuracy (or inaccuracy) of forecasting. Forecasting is an art as much as it is a science – and no leaders in the apparel industry have a guaranteed system for forecasting demand for designs, quantities, sizes, or colors. Forecasters – like designers and buyers – also benefit from last-minute decisions because it allows them to amass more intelligence from the market and incorporate current data into their calculations.

Gap Inc. is testing a new forecasting tool that "takes us to a more micro level and breaks it out more finitely to better plan capacity and resources which will, in turn, improve everything that goes into manufacturing." Today, forecasting is seasonal, but the tool will enable them to "give suppliers monthly numbers and also get to the level of women's tops and women's bottoms instead of women's units."

Production Management

Technology enables brands to implement management tools that improve communication and transparency throughout the product life cycle – from designing through sample-making, order placement, production planning, workflow management, sample approvals, and tracking of shipment documentation. Leading brands are using web-based technology, capacity management, and scorecards to manage the production cycle.

Gap Inc. is in the process of doing a “life cycle analysis that identifies key decision-making points for which we can provide guidance and coaching that should result in improved decision-making that will affect the workers in a positive way. We are coming up with more formalized ways of teaching the brands to look at total life cycle in order to do their jobs better.”

All brands operate on seasonal demand and there are periods of “peak production” for the suppliers. Gap Inc. uses technology “to look at seasonal swings ... to look at how to smooth out production volume, and to determine how they can use a facility during “off”-periods.” Gap Inc. found that “vendors appreciate assistance in managing production flows and trying to keep lines full as consistently as possible.”

Scorecards are used for pre-evaluations of facilities, capturing the technical capabilities of suppliers, tracking the quality of product produced, monitoring customer service, encouraging innovation, as well as tracking adherence to codes of conduct. They also help raise a factory’s awareness about how it is or is not meeting key performance indicators set by brands**. Gap Inc**. and others are beginning to use scorecards to “demonstrate to vendors that good performers get rewarded and get our business. Gap Inc. and others are beginning to use scorecards to “demonstrate to vendors that good performers get rewarded and get our business.

Pricing/ Costing

Buyers are under pressure to earn the highest possible margins on their product lines. Traditionally, many brand buyers would determine the price they believe retailers will pay for a

product, subtract the profit they want to earn and their shipping costs, and then calculate the product-cost they are willing to pay their suppliers. Because the prices for raw materials, overhead, and logistics are often perceived as fixed, without a product management, or lifecycle, approach to pricing, suppliers often resort to meeting buyers' demands by squeezing the variable costs they control – including wages, benefits, and working conditions. This has frequently resulted in wages, labor standards, and environmental health and safety protocols being compromised.

Gap Inc. utilizes a "component costing system that sources fabrics and trims more efficiently and uses them more efficiently to get better at getting to the cost of the product with better quality at the same time."

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