

# Case A.1

## Minding the Gap

### Making the best of your business environment

Gap Inc. was founded in 1969 with the opening of a single shop in San Francisco. As of 30 January 2016, it has 3275 company-operated stores worldwide and 446 franchise stores. Stores trade under The Gap, babyGap, GapKids, GapMaternity, GapBody, Banana Republic, Old Navy, Athleta and Intermix brands. With total sales of \$15.8 billion in 2015/16, Gap Inc. has large markets in the USA, Canada, the UK, France, Ireland, China, Japan and Mexico and is America's largest clothing chain and one of the world's biggest fashion retailers. It employs 141,000 people worldwide and has begun expanding into other countries. It has franchise stores in locations across Asia, Australia, Eastern Europe, Latin America, the Middle East and Africa.<sup>1</sup>

What makes it a global company is not just its stores in several countries, but the fact that it produces its clothes in many locations, mainly in the developing world, where wages are much lower than in industrialised countries.

But has it continued to be successful? Has it made any mistakes? What lessons are there for other businesses? How has its performance been affected by its business environment – by consumer tastes, by the actions of its rivals, by the state of the national and world economies and by government policy?

In particular, how would an economist analyse Gap's performance so as to advise it on its best strategy for the future? This is the sort of thing that business economists do and the sort of thing we will be doing throughout this book. We will also look at the impact of the behaviour of businesses on their customers, on employees, on competitors and on society in general.

So let's have a look at some of the issues facing Gap and how they relate to business in general and to the topics covered in this book.

### The market environment

To be a successful business, it is important for Gap to get its product right. This means that it must understand its market and how consumer demand responds to changes in price. We look at how markets work in general in Chapter 2 and then look specifically at consumer demand in Chapter 3.

To stay successful, Gap must both respond to changes in fashion and, to some extent, set fashion. To quote from the Gap website, 'We create emotional connections with customers around the world through inspiring product design, unique store experiences and compelling marketing.'<sup>2</sup>

But Gap hasn't always got things right. In 2000, it reported falling sales and profits and its share price plummeted. According to analyst Mike Goldman, from Verdict Research:

There's a lack of innovation. Go into a store and the styles and ranges haven't changed significantly.... The one-style-suits-all ethos of Gap may also have lost favour with consumers.

Gap may have to embrace “globalisation”, where they have the reach of a global company but are able to take local tastes into account.<sup>3</sup>

With an attempt to revitalise its brands, the Gap saw some turnaround in its fortunes between 2002 and 2004, with both sales and profits rising. But both fell again in 2005 and 2006. Part of the problem was a lack of responsiveness to fashion trends.

The group’s supply chain works with traditional lead times of around nine months, while competitors such as H&M, Charlotte Russe and Forever 21 have adopted “fast-fashion” lead times of less than three months, enabling them to respond far more quickly to fashion developments.<sup>4</sup>

We look at strategies to estimate, respond to and influence demand in Chapter 3.

Success in selling is not just about the design of the product. It’s also about getting the price right, and that depends a lot on what rival companies are doing. Gap’s prices must be competitive with those of Next, H&M, Top Shop, Marks and Spencer, etc. Chapter 5 focuses on pricing decisions.

Over the longer term, Gap has to make decisions about which markets to target. In 1986 it launched GapKids and in 1994 GapScents. In 1997 it opened its online store. Should it expand to furnishing fabrics or to a greater range of fashion accessories? Should it attempt to take over rivals? Should it expand to new countries, such as Australia, China, Mexico or Malaysia? In fact, it has expanded to all these countries (the latest being China in 2015), either with its own stores or with franchised stores.

Strategic decisions such as these are examined in Chapters 6 and 7.

## **Production and employment**

Being a profitable business depends not just on being able to sell a product. It also depends on how efficiently the product can be produced. This means choosing the most appropriate technology and deploying the labour force in the best way. We explore production and costs in Chapter 4 and the employment of labour in Chapter 8.

Gap is a vertically integrated company. This means that it is involved not only in retailing, but also in the production of the clothes it sells. To quote the Gap website again, ‘Located around the globe, employees in Gap Inc.’s Sourcing and Logistics group, along with our buying agents, draw up production schedules and place orders with approved third-party factories in the more than 50 countries where our products are made.’

Gap, as with other companies, must decide on how many workers to employ, what wage rates to pay and what the conditions of employment should be. Such questions are explored in Chapter 8.

Most of Gap’s garments are made in low-wage developing countries, where the garments can be made at a fraction of the cost in America or western Europe. One result is that Gap has come in for fierce criticism from the ‘anti-globalisation’ protestors about the employment conditions in its factories. According to the international human rights organisation, Global Exchange in 2002:

In Russia we were notified that Gap pays factory workers just 11 cents/hour and keeps them in slave-like conditions. Workers from Macao contacted the Asia Monitor Resource Centre in Hong Kong complaining of abusive treatment by factory managers, who forced them to work excessive

overtime and cheated them out of their pay. A delegation from the National Labor Committee in June 1999 reported that Honduran Gap factory workers are subjected to forced pregnancy tests, forced overtime, exceedingly high production goals, locked bathrooms, and wages of \$4/day, which only meet  $\frac{1}{3}$  of their basic needs.<sup>5</sup>

This raises questions of business ethics and what is known as ‘corporate social responsibility’. We examine these broader social issues in Chapter 9, along with government policies to encourage, persuade or force firms to behave in the public interest.

Clearly Gap was worried about the adverse press it was receiving. It was particularly concerned by the campaign by the American labour union UNITE, which highlighted conditions in factories producing clothes for Gap and other US retailers. Gap was thus at pains to be seen to be addressing the problem. In April 2004, the *Corporate Social Responsibility Newswire Service* reported that:

UNITE and speciality apparel retailer Gap Inc. announced that they are supporting an effort by displaced garment workers in El Salvador to open that country’s first independent and fully unionised apparel export factory. UNITE and Gap Inc. also said they plan to regularly discuss ways to co-operatively address garment factory issues that are of mutual concern to both organisations.

‘My daughter asked me if it was OK to shop at Gap now, and when I said “yes,” it instantly cost me \$80,’ said Bruce Raynor, president of UNITE.<sup>6</sup>

However, since these problems, [significant steps have been taken](#), and Gap Inc. was recognised as one of the world’s most ethical companies for the fourth year in a row in 2010. Alex Bringham, Executive Director of the Ethisphere Institute said:

Gap Inc.’s promotion of a sound ethical environment shines within its industry and shows a clear understanding that operating under the highest standards for business behavior goes beyond goodwill and ‘lip-service’ and is linked to performance and profitability.<sup>7</sup>

Nevertheless, Gap still faces considerable criticism for its employment conditions in developing countries. According to two 2013 Global Exchange briefings:

Since 2006, more than 600 Bangladeshi garment workers have died in preventable fires while sewing clothing for companies like Gap and Walmart. 112 workers died in a recent fire at a Walmart supplier and 29 workers died at a Gap supplier, but Gap and Walmart are still refusing to pay for reforms and join with other companies in a binding fire safety agreement that includes independent inspections and worker representation. Until there is real change, any day there could be another factory fire with workers locked inside.<sup>8</sup>

Anu Mandavilli, a spokeswoman for Friends Of South Asia, ... confronted Gap’s CEO Glen Murphy during the question-and-answer portion of the annual [Gap shareholders meeting in San Francisco]. “By charging only 10 cents more per garment, Gap could dramatically change Bangladesh’s garment industry,” Mandavilli told India-West, noting that Gap has 73 factories in the country. “But it is always a race to the bottom in this industry: you’re going to give the contract to whoever produces the goods most cheaply,” the Indian American activist stated, adding that vendors will be certain to take out their share, leaving very little for wages and improving workplace safety.<sup>9</sup>

## The economy

So do the fortunes of Gap and other companies depend solely on their policies and those of their competitors? The answer is no. One important element of a company's business environment is largely beyond its control: the state of the national economy and, for internationally trading companies, of the global economy. If the world economy is booming, then sales and profits are likely to grow without too much effort by the company. However, when the global economy declines, as happened in the recession of 2008/9, trading conditions become much tougher. Gap Inc.'s sales fell by 8 percent between the 2007 and 2008 fiscal years, from \$15.8 billion to \$14.5 billion, and then fell further to \$14.1 billion in 2009. By 2012, however, with the recovery in the US economy they had risen again to \$15.7 billion.<sup>10</sup>

We examine the national and international business environment in Part D. We also examine the impact on business of government policies to affect the economy – policies such as changes in taxation, interest rates, exchange rates and customs duties.

### Question

Choose a well-known company that trades globally and do a Web search to find out how well it has performed in recent years and how it has been influenced by various aspects of its business environment.

<sup>1</sup> 2015 Annual report (2016), p.16

(<http://www.gapinc.com/content/dam/gapincsite/documents/GPS%202015%20Annual%20Report.pdf>)

<sup>2</sup> [www.gapinc.com](http://www.gapinc.com)

<sup>3</sup> <http://news.bbc.co.uk/1/hi/uk/875926.stm>

<sup>4</sup> 'Size matters in challenge to turn round Gap's fortunes', *Financial Times*, 10 January 2007

<sup>5</sup> [www.globalexchange.org/campaigns/sweatshops/gap/background.html](http://www.globalexchange.org/campaigns/sweatshops/gap/background.html)

<sup>6</sup> [www.csrwire.com/print.cgi?sfArticleId=2654](http://www.csrwire.com/print.cgi?sfArticleId=2654)

<sup>7</sup> [www.earthtimes.org/articles/show/gap-inc-recognized-asone.1215193.shtml](http://www.earthtimes.org/articles/show/gap-inc-recognized-asone.1215193.shtml)

<sup>8</sup> <http://www.globalexchange.org/events/protest-call-gap-end-sweatshop-death-traps>

<sup>9</sup> <http://www.globalexchange.org/news/protestors-demand-gap-sign-bangladesh-worker-safety-accord>

<sup>10</sup> [www.gapinc.com](http://www.gapinc.com)