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Developing segments with high-profit margins – the Case of Gap Inc. in the United States

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Abstract

Gap Inc., a popular clothing and apparel brand, has expanded its operations around the world through company-owned as well as franchised stores in more than 30 countries The case study concludes that Gap Inc. faces the threat of being left out in the US market due to their inability to exploit their resources to the full extent when competing with their industry rivals. Based on a hybrid analysis approach, this study recommends that the group should keep their focus on developing segments with high-profit margins and updating their existing resources and capabilities so as to fully harness the opportunities and protect themselves from threats.

Keywords: Gap, developing segments, high-profit margins, United States

1. Introduction

Gap Inc. is a popular clothing and apparel brand founded in 1969 and headquartered in San Francisco, California, US (Gap, 2021a). The first store of the Gap Inc. was opened in 1970 and since then the group has expanded its operations around the world through company-owned as well as franchised stores in more than 30 countries including Canada, United Kingdom, China, Hong Kong and Mexico (Annual Report, 2019, pp.44). The group owns brands including the Old Navy, Gap, Banana Republic, Athleta, Intermix, Janie and Jack, and Hill City (Du, 2019). As of 30th January 2021, the group had 3,100 company-owned stores and 675 franchises across 45 countries (Gap, 2021b). The group sells their products not only in-store but also online. During the five decades of operations, Gap Inc. has faced several ups and downs. For example, they were market leaders in the US during the initial years of their establishment enjoying high brand loyalty. However, their various strategic issues have continuously affected their competitive position in the market, for example, the appointment of a chief executive officer with exclusive and robust experience in the field of retail and merchandising, and the appointment of new designers for redefining their existing image and streamlining the costs. The group continues to address these issues using different measures (e.g. closing down unprofitable stores in North America and other regions), but their operating margin has kept on declining, from 9.6% in 2015 to 3.5% in 2019 (Annual Report. 2019; pp.18). More recently, in 2020, the company announced plans to close around 350 stores in North America (Gap, 2020). Despite these challenges, their e-commerce business seems to be a promising domain (Daim, 2019). So, the main question here is: how can Gap increase the profitability of their products within the home market and achieve a differentiated position?

This case study applies Porter's five forces model to analyse the competition and competitive position of Gap in the United States. This model belongs to the positioning school of thoughts. To identify the competitive advantages of the firm, the cultural school and the widely accepted set of model VRIN (Valuable, Rare, Inimitable and Non-Substituable) are integrated in this research to analyse the data collected from the company's website and Annual Reports. To ensure the validity and reliability of the theoretical arguments, this research selected and analyzed literature from academic databases in the form of published papers, journals and articles. To take a critical approach to the case study, the researcher also gathered data about the company from news articles.

2. Theoretical approach

Among different schools of thoughts on the strategy formulation, the positioning school and the cultural school have been chosen for the current case study. By choosing a hybrid approach, the limitations of both the approaches could be minimized and a greater understanding of the organization and its strategic position could be acquired.

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2.1 The positioning school of thoughts

The positioning school of thoughts has a descriptive outlook for strategic management, focusing on the content of strategy which requires the management to determine their product position, product features, and target market to gain higher profitability (Iyer, et al., 2019). To achieve this, a company needs to explore the market competition and its current competitive position. Accordingly, the central focus of the positioning school is the industrial and economic angle for determining competition and competitive positioning. Based on this analysis, strategies for improving the position of the firm, its products and services can be improved (Mackelprang, et al., 2018).

For this case study, using Porter's five forces model to analyze the external environment (i.e. competitive rivalry) of Gap Inc. in North America will allow us to gain a better understanding of the factors currently driving the profitability in the clothing and apparel industry of the chosen region and the same can be then integrated with the strategies of the group. The analysis of the external environment using the five forces model would facilitate differentiating the group's market position and creating higher value in the market (Bruijl, 2018). However, there have been debates on the applicability of Porter's five forces model in the modern industrial environment with rapid changes in terms of consumer preferences and technological advancements. The model fails to explain the expansion of the factors affecting the industry attractiveness beyond the five competitive forces (Slattery, et al., 2016). Still, Porter's five forces model simplifies the market structure and evaluates the interactions among industry participants in a structured manner to assess the main causes of profitability in an industry (Grundy, 2006; Porter, 2008), and this assessment currently seems to be the prime strategic goal of Gap.

2.2 The Cultural School

The resource-based view of strategy or the cultural school describes strategy systems as social interactions that are based on the beliefs, traditions and understandings shared by the individual members of an organization. This school suggests that strategy formulation is influenced by unique values, decision-making style and overall organizational culture (Bromiley and Rau, 2016). Thus, a positive culture helps in innovations and promotes growth and sustainability. Taking an inside-out approach to strategy formulation, this school suggests that strategy formation is based on collective intentions and is reflected in the manner whereby the resources and capabilities of an organization are used for a competitive advantage (Rockwell, 2019). Thus, it can be said that using RBV of strategy, this study will be able to recognize key resources and capabilities of Gap which are unique to them and are not possessed by anyone else in the industry (sustainable competitive advantage). These unique factors can be used to reduce the competitive forces as identified in Porter's five forces model giving more profitability and long-term sustainability to Gap. However, since resources and capabilities are embedded in the culture followed by an organization, making changes to it based on external analysis may make its people resistant to the shift in the strategic perspective and create challenges for Gap (Hattangadi, 2017).

The VRIN framework, useful in measuring the competitive power of the resources and capabilities owned by an organization, covers various types of key resources (factors) as the acronym indicates: valuable (value to customer), rare, inimitable and non-substituable. The value factor of the framework determines whether or not the resources and capabilities will help the organization to cope with the threats and opportunities presented by the environment (Gamble, et al., 2019). The rare factor represents those resources can only owned by a small number of firms in the entire industry. The imperfectly imitable factors denote resources that provide the organization with a cost advantage over the rival firms and are exclusively owned by the organization itself. The last factor, 'non-substitutable' refers to those resources that cannot be replaced by other low cost or reliable or faster form of resources of other firms (Alexy, et al., 2018). If Gap does not possess any resources related to these factors, then the group can be considered to be at a competitive disadvantage; and if all those factors are present, then the group can be considered to possess a sustainable competitive advantage.

3. Environment analysis

In general, the industry environment in North America offers a low to medium threat of new entrants, no threat of substitutes, high bargaining power of buyers, low bargaining power of suppliers and high competitive rivalry. This study discusses in detail the two key competitive forces influencing Gap; buyers and competitive rivalry.

The bargaining powers of buyers depend on the number of buyers, the number of retailers, presence of substitute products, switching cost and intangible factors related to the brand as perceived by the buyers such as reputation, equity and loyalty (Luttgens and Diener, 2016). In this regard, although China has emerged as one of the largest fashion markets in the world due to its huge population and expanding middle class (Cavusgil, et al., 2018), the US remains in the market with the keenest buyers for clothing and accessories (Wang, et al., 2019). Meanwhile, the number of manufactures and retailers is also large in the USA with many small and medium scale importers and sellers operating in the industry. However, the number of companies (for example, Primark, Zara, H&M, Inditex) enjoying similar economies of scale, market presence and brand awareness as Gap remain low. Here, it can be argued that the switching cost of buyers will remain low considering there are different other reputed and higher equity brands catering to the needs of the American consumers. Hence, it can be said that buyers constitute a moderate force in the US. When analyzing the buyers' power, the five forces model does not take into account the changing shopping preferences and patterns of the consumers and the rapid growth of the technological environment in the industry (Jin and Shin, 2020). Therefore, in regard to helping researchers gain the understanding of industry's growth mechanism and its future prospects, this model has its limitations.

Analyzing the competitive rivalry factor, can, however, to some extent overcome the above limitations. The analysis is dependent on four factors: industry competitive structure, demand conditions, cost conditions, and exit barriers (Khan, 2015). In this context, the apparel and clothing industry of North America is consolidated with the market dominated by a small number of large firms such as Nike, Levis Strauss, Under Armor (Statista, 2020). All of these brands have established their own customer base with high-quality products matching the lifestyle needs of American consumers. More importantly, these brands have focused on research and innovation more than Gap, and offered new products and channels of marketing and communication to satisfy consumer needs. Therefore, the price within the industry will be determined by this group of sellers and a differentiated price will only pay off if Gap is able to offer unique and innovative product and experience. In terms of demand conditions, it is observed that the customers' demands have been increasing in 2018. North America including the US is considered as the most optimistic region for fashion sales; however, it is also discovered that consumer preferences have significantly shifted with consumers now seeking value and small brands due to their authentic narrative (McKinsey & Co., 2019). Hence, it can be said the declining demands of traditional clothing and apparel products such as fast fashion has increased the rivalry in the market and with firms battling to maintain their share and revenues, those able to cater to the emerging needs of the consumers will be the only survivors.

New entrants, namely Gap's competitors, adopt disruptive business models to further enhance the competition. For example, one newcomer, Ba&sh, a French label offering free rental services for clothes in New York, is expanding quickly in North America (McKinsey & Co., 2019), suggesting the threat of new entrants is moderately high as the disruptions such as sharing economy and digital innovations have reduced the profit margins of existing firms in the industry. Other such firms like Rent the Runway also pose a moderate threat to the profit margin and competitive position of Gap in the US (Business Insider, 2018). The third and fourth factors - cost structure and exit barriers - are interrelated. The fashion retail industry is based on high fixed costs of setting up manufacturing units, physical stores and establishing back-offices for managing the operational work, so the profitability will be mainly driven by sales number (Schrewentigges, 2018) and the intensity of rivalry in the US is high. Now, since, high cost is involved in setting up the business and achieving economies of scale, the exit barriers of the industry are high. In particular, just like Gap, other known brands such as Nike and H&M tend to remain in the market as exiting the market is not economic to them. In the current industry fashion industry of the US, existing retailers have adopted different strategies for increasing the intensity of competition. For example, Gap itself has switched from a brick-and-mortar store only business model to an Omni-channel strategy, now focusing on further improving its digital presence and consumer experience (VMware, Inc., 2021). H&M also adopted a circular approach to shopping which promotes eco-friendly habits among consumers (H&M Group, 2021). This strategy puts competitors under pressure to adopt further differentiating approaches to enhance in-store and online shopping experiences, thus, increasing the competition intensity.

4. Evaluation of Gap's competitive advantages

This section utilizes the cultural school's model to analyze the key resources and capabilities that help Gap to differentiate itself from other companies in the US. In this context, through an analysis of the external environment (industry analysis) using Porter's five forces model, it was found that Gap, as a household name in the US, has high brand awareness mainly because the company has operated in its home market (USA) for the last 51 years and despite lower profit margins, the group has maintained its sales steadily (Annual Report, 2019; pp. 44). Although this intangible resource (inimitable corporate culture & history) can be useful in creating value for the firm, brand equity is an inimitable and non-substitutable factor because it would require high costs for producing and selling high-quality products and years of work for developing a brand reputation with years of work. It is not rare as other companies such as Nike also enjoys the same status, so it cannot be classified as a sustainable competitive advantage for the group (Rahman, et al., 2018).

The Omni-channel presence of the brand through physical stores in the US and presence on online platforms is a valuable intangible resource (Gap Inc., 2015), but is not rare because in the contemporary industry environment all the major competitors of Gap are selling through online channels and the products of other small brands and disruptors are also available on e-commerce platforms. The group has developed trust among the American consumers by providing them price-competitive, variety of quality products (Nisar and Prabhakar, 2017) which is a rare and intangible resource useful in reducing the threats from the new entrants. However, Gap does not seem to have the competitive edge over larger firms: the company does not have a core luxury brand or offer specific fast-fashion products of low quality at cheaper rates; and its products are outdated and do not match with the demands of the consumers or the frequent innovations that similar companies such as Nike have been doing frequently. It can be said that when Gap entered the US market, the market was blue ocean (the uncontested market space) with several opportunities, low competition and static demands of the consumers. After Gap entered the market, technology has advanced, disruptive models of business have emerged and the existing fashion retailers have continuously invested in identifying market needs (Jin and Shin, 2020). Gap Inc. is identified as a late adopter, mainly in the context of research and innovation and if they do not innovate their existing business model, they may face the consequence of losing their rare resource "customer satisfaction" (Forbes, 2020). It is important that Gap Inc. evolved its core value proposition to acquire a sustainable competitive advantage.

5. Limitations, recommendations and conclusions

5.1 Theoretical limitations

The study adopted a hybrid approach using Porter's five competitive forces framework and the VRIN framework to analyze the case of Gap Inc. in the US. Nevertheless, the approach does have certain theoretical limitations. First of all, both the five forces model and VRIN model are static models, and they are both time-sensitive. Using them to analyze this case study of Gap, a large medium enterprise, it is difficult to evaluate and judge the environment and information in real time. Therefore, those limitations may have hindered the understanding of the competitive position of the firm and the drafting of suitable strategic recommendations. For future studies, the Design and Planning approach and the tools such as Ansoff's Matrix and PEST analysis can constitute a multi-dimensional approach to the analysis of the external environment of Gap and their strategic response to them (Shtal, 2018) . Furthermore, using PEST, environmental factors can be identified and by studying their impact on the five competitive forces, the competitive strength of Gap with respect to the industry could be demonstrated in a robust manner (Helmold, 2019).

5.2 Future strategy for Gap

Based on the industry analysis and the understanding of the resources and capabilities providing a competitive advantage to the group, two strategies are recommended to Gap to regain its competitive position in its domestic market. First, Gap should focus on identifying 'blue ocean segments '(Karaoulanis, 2018) in the US such as the online sales and sharing business model, which will increase barriers to entry for new entrants as well as existing firms. The aim is not to reduce but beat the competition by focusing on the core value proposition and delivering the household name value which Gap enjoys in the US. The company should improve the experience of customers both within stores and online shopping stores. Thus, the key to future success lies in exploiting existing markets with unexploited potential through differentiation in products or communication or delivery chain domains (Omar, et al., 2019). This will assist the company in preserving valuable resources of brand awareness, loyalty and satisfaction and converting them into a sustainable competitive advantage.

Second, Gap should improve their resources and capabilities by analyzing the existing ones and identifying those requiring appraisal using the VRIN framework. Although it may encounter resistance from employees (Che, et al., 2019), the change can be swiftly executed by using appropriate communication transparency.

6. Conclusion

The case study concludes that Gap Inc. faces the threat of being left out in the US market due to their inability to exploit their resources to the full extent when competing with their industry rivals. Based on a hybrid analysis approach, this study recommends that the group should keep their focus on developing segments with high-profit margins and updating their existing resources and capabilities so as to fully harness the opportunities and protect themselves from threats.

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