Since it started in 1969, Gap Inc. has been consistently expanding. With more than 1,500 stores in the United States, Canada, the United Kingdom, France, and Australia, Gap Inc. is currently the second largest selling brand in the world and is ranked second among all U.S. retailers in sales.

**A HISTORY OF GAP INC.**

Gap Inc. was established in August 1969 by Donald G. Fisher, a real estate developer educated at the University of California, Berkeley. Fisher conceived of the idea when he went to a department store to exchange a pair of Levi’s and was unable to because the jeans department was so disorganized. Backed by a $63,000 family investment and a $112,000 bank loan guaranteed by his father-in-law, Donald Fisher introduced the first Gap store in San Francisco. His original idea was to focus on the mid-teen market with three types of goods: records, cassette tapes, and Levi’s jeans. Unlike the local department stores, which stocked only a limited number of styles and sizes of Levi’s jeans, the Gap store carried every size and style available. Furthermore, they were neatly arranged and easy to find. Donald Fisher and his wife had a discussion about the “generation gap” in 1969, and from that discussion came the name Gap Inc., under which the company was incorporated in California in July 1969. Gap Inc. was reincorporated in 1988 under the laws of Delaware.

**Growth and Expansion**

Although the original targeted customers were primarily young people, the convenience of a neatly organized jeans store with Levi’s products attracted customers of all ages. In less than one year, Gap’s business took off, and a second Gap was opened in San Jose. In less than two years, there were six Gap stores in California. By 1972, Gap Inc. had 25 stores in six states. In 1973, Gap Inc. ventured into the East Coast market, opening 12 stores in New York, New Jersey, and Pennsylvania. In 1974, Gap expanded into Washington, Minnesota, Missouri, Oklahoma, Maryland, Virginia, Georgia, Arizona, Texas, and Illinois, with a total of 90 stores. In 1976, Gap Inc. went public with its stocks selling at 75 cents a share. In 1979, Gap Inc. opened a modern distribution facility in Denver, Colorado. By 1981, Gap Inc. had opened 500 stores nationwide. In 1983, Gap Inc. purchased Banana Republic. By 1985, there were 613 Gap stores and 35 Banana Republics. The first GapKids store was introduced in 1987, then in 1988, the Old Navy Clothing Company was first introduced. In the same year, Gap opened two factory outlets selling merchandise at discount prices. In 1990, GapKids formed a separate department for baby clothing called BabyGap. In 1992, Gap stores also formed a separate department called Gap Shoes. As of February 1999, the company operated:

- 2,448 stores in the United States, Canada, United Kingdom, Germany, and Japan, including 165 Gap stores and 133 GapKids in international locations
- 292 Banana Republic store, including 10 in Canada
- 407 Old Navy stores
- 101 stories in the United Kingdom, 117 in Canada, 31 in Japan, 30 in France, and 11 in Germany

**Selling Private Store Brand Product**

Within three months of opening the Gap, Fisher realized that the real business was in selling Levi’s jeans, so he dropped the records and cassette tapes from his inventory. Until the end of 1973, Gap advertised and carried only Levi’s brand products. In 1974, Gap introduced its first private-label clothing into the merchandising mix. When price maintenance crumbled because of a Federal Trade Commission directive in 1976, Levi’s products began to sell at discount, and Fisher was convinced that Gap’s competitive advantage could not rely solely on the low prices of Levi’s products. Since then, he has focused on reducing Gap’s reliance on sales of Levi’s products. As a result, Levi’s products began to decrease as a percentage of Gap’s total sales. By 1987, Levi’s made up less than 50 percent of Gap’s total sales. By 1985, Levi’s sales dropped to 21 percent of Gap’s total sales, then 14 percent in 1987. Finally, in 1990, Gap dropped Levi’s altogether and started selling only private-labeled products.

**GAP INC. OPERATING COMPONENTS**

Gap Inc. is a specialty retailer that operates stores selling casual apparel, shoes, and other accessories for men,
Gap Inc. operates under five different divisions: Gap, Banana Republic, GapKids, Old Navy, and International Division. The first four operate domestically, and the last one operates all of the stores from the first four divisions that open overseas. The company continued to expand internationally in fiscal 1998. It is faced with competition in European and Japanese markets from established regional and national chains. If international expansion is not successful, the company’s results of operations could be adversely affected. The company’s ability to grow successfully in the continental European markets will depend in part on determining a sustainable profit formula to build brand loyalty and gain market share in the especially challenging retail environments of France and Germany.

Gap Division. This division has by far the most stores—more than all of the other divisions combined—with 944 stores operating in the United States at the end of 1998. The Gap Shoes subdivision also operates under this division. All stores under the Gap division are called The Gap. The Gap stores are classified as clothing stores for men and women, with Standard Industrial Code 5651. In the United States, there are 145 domestic competitors for The Gap; and in 1998 The Gap ranked third in sales. In the beginning, products under this division consisted of an assortment of unisex basics; but recently they have evolved to become more gender specific.

Banana Republic Division. When purchased in February 1983, Banana Republic was already famous for its travel and safari wear, but only two Banana Republic stores existed. After the purchase was completed, the parent company created a new division to operate all Banana Republic stores. Gap Inc. also invested capital to create a product development and production team for Banana Republic, allowing it to introduce its own new private label fashions. In addition, there was rapid expansion into other parts of the country. Products under the Banana Republic division are more upscale, more tailored, and come in more refined fabrics than those in The Gap stores. Leather goods and jewelry goods have been introduced into the merchandise mix.

GapKids Division. After this division was formed in 1986, it became the fastest growing division of Gap Inc. A II stores under this division are called GapKids stores. Products in this division are essentially miniature versions of The Gap products, but with more focus on color variations. These products have also switched from unisex to more gender specific. The formation of the BabyGap subdivision under GapKids is another reason for the rapid growth of this division.

Old Navy Clothing Company Division. This division operates all Old Navy Stores and Gap Warehouse. There are now 407 Old Navy stores operating under this
division since the first introduction in 1994. There is also a Gap Warehouse operating under this division. The formation of the Old Navy division came at a time when sales were down, and Gap Inc. needed new ways to attract customers. The strategy was to sell merchandise similar to Gap stores but at lower costs. This division is expected to surpass the GapKids division and become the fastest growing division of Gap Inc.

**International Division.** All stores located in foreign countries are under the control of International Division, which is led by Executive Vice President Kenneth S. Pilot. This division currently includes Gap stores, GapKids stores, and Banana Republic stores, but not Old Navy stores. The first overseas store was established in 1987 in London, thus gaining entry into the British apparel market. In 1988 the first store in Canada was established, and in 1993 the first in France was opened. As of 1994, the International Division operated 40 Gap and GapKids in England, 59 in Canada, and 3 in France. International Division also operates Banana Republic in Canada and Australia. International Division shows strong growth potential and continues to expand existing markets in Europe and gain major entry into two new markets: Germany and Japan.

**Products and Customer Base**

The Gap division sells mainly men’s and women’s casual and active wear. Clothing items include jeans, sweat suits, sweatshirts, denim wear, and polo-style pocket T-shirts. The Gap division has also expanded its market to include handbags, shoes, and a higher fashion line of evening wear. In addition, during the 1990s the Gap division entered the bodycare products and cosmetics market, introducing soaps, body lotions, shower gels, shampoos, conditioners, aromatic candles, and other related items. In addition to selling travel and safari wear, the Banana Republic division sells men’s and women’s casual wear, made of finer fabrics and priced higher than can be found in Gap stores. Together, the Gap stores and the Banana Republic divisions target mainly customers 20 years or older. GapKids, which sells miniaturized versions of Gap store products, originally aimed at children aged 2 to 12, but with the introduction of BabyGap, it has been able to add even younger customers to its customer base. Old Navy Division, selling cheaper products, targets lower-income shoppers. International Division targets foreign customers in similar age groups mentioned earlier.

**Sourcing and Distribution**

Gap purchases merchandise from some 700 sources located both in the United States and overseas. This procurement strategy is designed to reduce each supplier’s importance, so that no single supplier can affect Gap’s overall operations significantly. All suppliers account for no greater than 5 percent of the purchase. The suppliers manufacture the Gap’s private-label merchandise according to the company’s specifications. Gap purchases are comprised of 40 percent domestic-made merchandise and 60 percent foreign-made merchandise. Of the foreign sources, approximately 23 percent are from Hong Kong, and the remaining purchases are spread across 42 other countries. Hong Kong, Taiwan, South Korea, Singapore, and China constitute over 50 percent of Gap’s foreign merchandise sources. Sudden political instability in any of these countries could quickly have an adverse effect on Gap’s sourcing operations, as would any imposition of import restrictions such as tariffs and quotas by the U.S. government on products made in these countries. Both the recent threat by the U.S. government to deny China most favored nation (MFN) status and China’s impending takeover of Hong Kong in 1997 are causes for great concern for Gap’s management.

Hong Kong is by far the most important foreign source of Gap’s merchandise. Hong Kong has a total population of 6.019 million, of which 17.8 percent are engaged in manufacturing and 33.6 percent are in either retail trade or wholesale. Until recently, Hong Kong had an unemployment rate of only 2.2 percent, and the Hong Kong government has to import labor from abroad to counter a shortage in labor supply. Despite this labor shortage, the well-educated labor force in Hong Kong is relatively cheap to employ, and with the increased pressure of manufacturing companies moving across the border into China, even cheaper labor may result. U.S. retailers, including Gap Inc., have long been the target of criticism for selling goods imported from Hong Kong and other low-wage countries such as Taiwan and South Korea. In addition to its low wage rate, Hong Kong is a favored apparel source for many retailers because of the flexible manufacturing and quick response strategies introduced by the Hong Kong Productivity Council and adapted by many of Hong Kong’s apparel producers. Both of these strategies reduce inventory costs for the retailers. Furthermore, the apparel industry in Hong Kong is now adapting to many new technologies and production methodologies, all aimed at reducing apparel production costs. Problems that might arise in the future include increased cost for apparel items from Hong Kong because of the strengthening of the Hong Kong dollar against the U.S. dollar, and the fear concerning Communist China’s takeover in 1997. Despite the takeover, the leading spokespersons for Hong Kong’s apparel industry are mostly optimistic that Hong Kong’s apparel industry will remain strong.

All merchandise is shipped to distribution centers for distribution. These centers are located in California, Kentucky, Maryland, Canada, and the United Kingdom.
GAP'S EXISTING FOREIGN MARKETS

Gap’s existing foreign markets include Canada, the United Kingdom, France, and Australia. Following is a detailed analysis of each market.

Canadian Market

As store openings increased across the United States during the 1980s, Gap Inc. began to realize the potential for expanding into the Canadian market.

General Economy. During the mid-1980s, prior to Gap Inc.’s Canadian involvement, Canada enjoyed a stable and slowly growing economy. This brief boom was followed by a recession in the late 1980s. While other Canadian companies suffered, Gap Inc. sought to gain first-mover advantages by riding a possible rebound in the economy and tried to become a dominant player in the Canadian apparel industry. The Canadian government imposes few restrictions on foreign direct investment. This was a major decision factor in Gap Inc.’s move to set up stores in Canada with the opening of eight stores in Vancouver in March 1989. The first of these was in Vancouver’s Pacific Center.

Government Regulations. Since it is a good environment for apparel market penetration, Canada subscribes to the General Agreement on Tariffs and Trade. This greatly influenced Gap’s later decisions to expand into other countries as well. Even though Gap Inc. conducts its sourcing mostly outside of the United States, it ships those goods back through the United States, so that they have to be imported into countries like Canada. In addition, Canada’s goal of totally eliminating tariffs on goods of U.S. origin by 2000, which it has already begun implementing, provides Gap Inc. with an advantage on entering the Canadian apparel market. This trend has enabled American companies like Gap Inc. to lower their cost of doing business in Canada by making it cheaper to import their products from the United States. Canada even assists U.S. companies planning to enter the Canadian market through the United States and FCS Export Assistance Service. Along with fewer government restrictions, Gap Inc. did not encounter the traditional barriers of entry such as local content requirements, political turmoil, and import quotas.

Market Expansion. In 1992, Gap Inc. made a big expansion move further into the Canadian apparel market. In a joint venture with John Forsyth Company Inc., Gap Inc. began to compete on the same level as native Canadian apparel companies such as Hudson Bay Co. With the impending North American Free Trade Agreement, Canada’s borders were now completely open to outside competition. This development paved the way for even more store openings for Gap Inc.

Now, Gap Inc. not only has to compete with Canadian apparel companies like Hudson Bay Co. for market share, but also with new U.S. companies in Canada such as The Limited. This increased competition has made Gap Inc. look at further Canadian expansion from a different perspective. According to Gap Inc.’s Ken Rapp, “The holdup is no longer a free trade issue, but a dearth of good retail space in Canada where there are fewer shopping malls per capita and lower vacancy rates.”

With ever-increasing success, Gap Inc.’s Canadian stores began to branch out with Canadian versions of the U.S. GapKids and Baby Gap in the early 1990s. This expansion was made possible in part by Canada’s recovering economy and notable growth in the apparel industry. Turtleneck jerseys, a Gap staple, rose in sales 122 percent. Men’s outerwear rose 17 percent after a three-year decline.

Growth Projections. Riding on the success of Gap and GapKids stores, Gap Inc. believes its Banana Republic division will not have a difficult time establishing stores in Canada. Banana Republic, a more upscale, higher-priced version of The Gap, opened stores in Eaton Centre in Toronto and West Edmonton Mall in Alberta. Gap Inc. seeks to steal some market share from existing Canadian chain stores such as Roots, River Road, and Eddie Bauer by installing Banana Republic stores. As of February 1995, Gap Inc. had plans to open thirty more Banana Republics within the next five years.

Market Characteristics. According to the International Trade Administration’s Canadian Market Overview, the new trend in the Canadian apparel market is to economize by saving money on clothing. This is because of increases in housing costs and taxes. Female consumers are becoming more time-pressured, and as a result, they are spending half as much time per month shopping as they did ten years ago. In general, adult consumers are becoming more knowledgeable about the clothing they buy and are more careful in evaluating their purchases in terms of value.

United Kingdom Market

According to U.K. trade journals, American apparel is making a strong show in the British market and will continue to do so in the near future. Approximately 60 percent of men’s apparel and 35 percent of women’s apparel are sold through retail stores.
Market Size. According to the 1991 International Market Report, the British market for men's apparel is about $3.34 billion, and the women's apparel market is about $4.59 billion. Both are in decline because of recession.

Market Health. The U.K. market for apparel is currently in a recession. British retailers are hoping for "business as usual" once again in the not too distant future, but according to market analysts, recovery is still a long way off. There are occasional mini surges in consumer spending, and retailers have devised some strategies to capitalize on these surges. One strategy is to lower price while stressing quality. Another is to adopt the "one-stop-shopping" concept, that is, pairing men's and women's merchandise together in one store so both can be bought simultaneously. This strategy was in response to an observation that consumers now have a tendency to come in couples. Some retailers even place children's apparel items along with men's and women's apparel items, thus creating a true "one-stop-shop."

Market Trends. British consumers are highly receptive to U.S. designed and manufactured apparel items. Studies show that the average British consumer thinks of American designers as firm believers in making practical clothes for real people, as compared to European designers who make fashion show-style clothing that is unwearable. Outerwear sold by such retailers as Gap Inc. and Timberland is very popular. Men's and women's apparel trends differ in that menswear tends to be more basic; the changes are usually in color and fabric, not style. Men are moving toward plainer pieces and away from heavily logoed styles. Women purchase with more focus on fashion designer labels.

Customer Base. The 15-25-year-old age group tends to make purchases in boutiques. Older consumers shop in stores that are well known for quality, durability, and good value. Most retailers now are focusing on customers who are over 25 years old. This is because of increasing youth unemployment and an aging population of baby boomers. A significant percentage of the customer base is made up of large-sized customers, particularly women.

Competitions. American-made apparels face competition from European designers, Asian-made apparels, and from each other. European designers from the European Union can ship their goods to the United Kingdom duty-free, and Asian-made items are usually produced by cheap labor.

Government Regulations and Market Access. There are few trade barriers for apparel. No special forms of documentation are required for apparel items going to the United Kingdom. No special standards are set. No import licenses are necessary. Textile raw materials enter the United Kingdom with up to 15 percent duty, while finished apparel items are charged with up to 14 percent duty and value-added tax of 17.5 percent. No duties have to be paid for goods imported temporarily to the United Kingdom or located in freeports (UK free-trade zones).

French Market
France is Gap's newest foreign market, and so far only three Gap stores operate in France. The following analysis of the French apparel market includes size of market, characteristics of growth, growth projection, industry structure, competitors and substitutes, and government regulations.

Size of Market. According to the U.S. Department of Commerce World Apparel Market Research Report published recently, France was the sixth largest market for apparel, with demand of more than $12 billion. It was also the sixth largest market for apparel imports from the United States, with total demand of $200 million.

Market Characteristics and Current Growth. The French apparel market can be characterized as a mature, sophisticated, slow-growth market rather than an emerging market. It is experiencing 4 percent average annual growth and 2 percent annual growth in its market for U.S. imports. The United States does not have a large share of the French market at the moment. However, the French are becoming more receptive to U.S. fashion, especially U.S. sportswear. French women are just beginning to buy American-made apparel, and the natural "American look," especially Western-wear clothing, is becoming popular in France. The 15-25-year-old age group is very fashion conscious and strongly influenced by American styles, especially jeans and college or football team logo apparel.

Growth Projections. The industry has suffered from the worldwide economic slowdown since 1991, but some sales improvements have occurred since 1994. Apparel sales are expected to grow at a rate of 2 percent. In spite of the low market share of U.S. firms, France is very promising for Gap Inc. The French have a high level of receptiveness to U.S. goods, and the market for U.S. imports is expected to continue to grow at 2 to 3 percent annually. Unfortunately, local and third-party competition is high, but market barriers in this area are negligible and do not pose a problem. According to the U.S. Department of Commerce International Trade Administration, the current two most promising subsectors in apparel for U.S. companies are sportswear and jeans.
Business Environment. The French commercial environment is very dynamic and sophisticated, and reflects consumer trends quickly. There is a strong market for high-quality consumer goods. Independent specialty stores are the main means of distribution in affluent cities.

Business Attitude Toward the United States and Exit/Entry Barriers. In general, the attitude toward American companies is favorable and the French are quite receptive to U.S. goods and services. However, strong interest groups have a lot of power in influencing business judgment and government action or inaction. These interest groups have been known to stage noisy demonstrations, but they usually are only a problem for companies that pose a major threat to French suppliers. There are no major entry or exit barriers to doing business in France for most companies. Tariffs and duties on American products are discussed later.

Competitors and Substitutes. Local and third-party competition is rampant in the French market. It is particularly heavy in the consumer area where buyers are just beginning to look for value in their product choices, and most product lines that are available are mature. In this mature and sophisticated market, consumers are well served by suppliers around the world. Therefore, it is unlikely that any major business breakthroughs will occur, but opportunities can be created in niche markets. There is a natural tendency now for the French to buy apparel from within the European Union because of the increasingly free flow of goods since the integration of Europe. Italy is and always has been a significant high-quality clothing competitor in France. However, Gap's main competitors are North African and Southeast Asian companies, which have a strong presence in France because of their low production costs. At the moment, Asian countries have 31.7 percent of the French market for women's clothing, and this number is expected to remain constant.

There has also been an increase in imports from Morocco, Tunisia, Portugal, and, recently, East Europe. Again, companies from these countries enjoy low production costs and close proximity to the French market. Morocco and Tunisia are actually the main suppliers of menswear imports to France, but the U.S. share of the menswear market has been increasing rapidly.

As far as substitutes, there has been a massive growth of supermarkets and hypermarkets (huge shopping stores with a wide variety of products) in France. This is not just in food but also in apparel. These stores could pose a threat to specialty stores such as The Gap if people begin doing all of their shopping at hypermarkets and stop going to the specialty stores.

Government Regulations and Controls. France has had a tradition of highly centralized administrative and governmental control of its essentially market economy. However, the apparel industry has little restrictions other than tariffs and duties on imported products. As part of the European Union, the TARIC system applies duties to all imports from non-EU countries. This gives European companies a slight cost advantage over U.S. companies. However, this can be negated if production costs for U.S. companies can be lowered. Duties on manufactured goods from the United States are moderate, ranging from 5 to 17 percent; they are calculated as a percentage of the value of the imported good. Under the Lome Conventions, varying preferential tariff treatment is given to imports from developing countries in Africa, the Caribbean, and the Pacific, which gives companies an incentive to manufacture in these countries.

Australien Market

Following the lead of successful U.S. retailer Toys “R” Us, Gap Inc. has been negotiating possible sites for another international outlet. Store location, product positioning, and marketing and advertising decisions depend heavily on how Gap executives assess the following conditions.

Economic Health. Consumption expenditures continue to increase in the face of high unemployment, which rose in 1992 by 2 percent, and by 7 percent in 1993. A reverse in this trend in 1994 and 1995 has since been the key to a robust recovery. The average annual growth rate for the apparel market during this period is expected to be between 3 and 5 percent.

The downward push against inflation was one of the few positive effects of the recent recession. Lower inflation numbers are a positive sign to potential investors, many of whom have been discouraged by the sliding Australian dollar. A strong local currency is helpful for specialty retailers like the Gap on two levels. First, its products will become relatively more price competitive. Second, Gap would benefit from a strong Australian dollar through translation gains, as profits are repatriated. Others are wary that the removal of quotas and tariffs will foster a fiscally unhealthy demand for imports. If past performance is any indication, economic expansion would most likely lead to a rise in the current account deficit. Officials cite that if the president’s goal of 4 to 5 percent GDP growth is realized, the current account deficit will increase from 3.75 to 4.25 percent of GDP during the same period.

Market Barriers and Government Regulations. In the recent past, currency exchange-rate levels and hefty import duties made it difficult to sell U.S. apparel products
Competitors and Competition. Competitors vying for the U.S. $1.5 billion in apparel revenues include traditional department stores, discount retailers, mail-order companies, home shopping clubs, and a growing contingent of specialty shops, including Gap. Industry sources estimate that 15 percent of the market is captured by traditional retailers, and 85 percent of the market is sold through other means. Experts also say that, of the expected 4 percent growth in the apparel market, an increasing proportion is expected to be captured by competitively priced imports. Competitors in Australia’s apparel market include department stores, chain stores, boutiques, and mail-order companies.

Department store leaders like Coles Myer, David Jones, and Georges sell to the middle of the market. These stores tend to sell higher-quality apparel goods, with various departments devoted to discount and specialty apparel. Coles Myer, for example, has a Myer’s Bargain Basement department, and its rival Georges offers a floor devoted exclusively to international apparel. Gap will take business mainly from David Jones and Coles Myer.

Chain stores and boutiques generally sell according to the selective tastes of their target markets. Gap stores are somewhat different from these retailers in that they would sell Gap brand items exclusively. Sportsgirl, catering to female teenagers, and Portmans are the largest in this segment and would compete directly with the Gap.

Mail-order companies and home shopping clubs are competitors without bricks-and-mortar shops. Through its subsidiary Myer’s Direct, Coles Myer has broadened its attack on consumers on two fronts: mail-order catalogs and a new home shopping program. The initial response to the home shopping program was not very enthusiastic; however, its mail-order business, the largest in the country, has been more successful, averaging 50 to 60 percent growth since its inception in 1989.

**Positioning.** Gap Inc. should continue to take advantage of its niche appeal as a U.S./California-based apparel company. Though U.S. companies, in general, face heavy competition in Australia, single brand stand-alone stores like the Gap will always find opportunities in niche markets. Gap should avoid competing on the basis of price with imports from China and Hong Kong. Gap’s greatest initial success will come from providing one of Australia’s populous cities, such as Sydney or Melbourne, fashionable, high-quality “American” apparel products.

**NEW MARKETS FOR GAP’S ENTRY**

As of 1995, Gap Inc. had announced plans to expand into two new markets: Germany and Japan. Following is an analysis of the two markets.

**The German Market**

Although no contracts have been signed, Gap’s financial director Robert Fisher has announced his company’s intentions to open a store in Germany. Gap executives must consider the following challenges and opportunities that are unique to the German apparel market.

**Market and Economic Health.** In 1998, Germany was ranked at the top of the list of apparel importers at more than $30 billion. A closer look shows that the most promising subsectors were sports, leisure and casual wear (U.S. $7 billion) and jeans wear (U.S. $4 billion). Average annual growth for Germany’s apparel industry through 2000 is estimated to be around 3 percent.

The German clothing industry fared well under the prevailing conditions of the late 1980s and early 1990s, which were a result of the ongoing reunification process. The opening of East Germany, with a population of 16 million, offers potentially large profits and a number of challenges for apparel managers seeking new markets. For the most part, apparel retailers are choosing to enter this market through joint ventures and partnerships, but others, like Levi Strauss, have chosen to establish their own branches. Still, progress in this region is painfully slow as the transition from a command economy to a market economy progresses.

**Consumer Attitudes.** Consumer spending is an integral part of economic growth in Germany and for Europe as a whole. Lately, however, German consumers have been
unwilling to participate, and recovery in the region has stalled. Several factors have contributed to this cautious consumer attitude: rising unemployment, which was already 10 percent, higher rents, which have increased by 6 percent in the west and by as much as 58 percent in the east, and high tax rates—currently 34.4 percent for the average worker. Even Germans from the east, who were hungry for consumer goods from the West, are becoming finicky shoppers. The bargain shopping attitude that is prevalent in the United States has found its way to East Germany. “They don’t buy so many trendy articles—it’s back to basics like T-shirts, jeans, blazers, and sweaters.”

**Competitors and Competition.** Because of these recent changes in consumer attitudes, low-cost apparel imports now dominate the German market. Basic items from Eastern Europe, Turkey, and Asia can be found for one tenth of the price of comparable U.S. offerings. This is not to say that consumers in Germany are not willing to pay higher prices for U.S. goods. Items must not only be of good quality, but must also carry a well-known American trademark.

Leading competitors include Hugo Boss, a menswear manufacturer and retailer that is currently the most profitable in Germany. Boss’s success is mostly a result of repositioning its product lines. It has recently included a lower-end product line under a different label, in addition to its traditional mid-priced and premium-priced offerings. Gap will be in direct competition with Hugo Boss for casual wear revenues. Adler, a discount fashion chain, has 60 stores in Germany, 10 of which were recently opened in East Germany. Gap should avoid competing head to head with Adler on a price per unit basis.

**Positioning.** Initially, Gap executives should expect to spend a considerable amount of capital in this market. A strong initial showing is important if Gap wants to become a recognizable American label. Germans have shown a willingness to pay a premium for highly recognizable American goods and have done so, paying between $80 and $100 for a pair of Levi’s jeans. Strong, pervasive television and print advertising is the key to creating this image awareness.

**The Japanese Market**

With a total population of 125 million people, Japan would make an excellent market for Gap’s products. The following is an overview of this market.

**Size of Market.** The U.S. Department of Commerce World Apparel Market Research Report shows Japan as being the largest total market for apparel, with total demand of $70 billion. It is the second largest market for apparel imports from the United States, with a demand of over $600 million, but this statistic is slightly misleading. This is because the Dominican Republic, which tops Japan in this category, is merely a major assembly point for U.S. apparel and not a major market. The goods are assembled there in a low-cost environment but are transported abroad and sold in other countries. Thus, Japan is in reality the largest market for U.S.-made apparel products.

**Market Characteristics and Current Growth.** As a result of the economic recession in Japan over the last several years, the average annual growth rate for apparel in Japan has only been a meager 2 to 3 percent, but imports from the United States have been increasing at an annual rate of 11 percent. This large growth is due to the boom of “American casual fashion” in Japan.

In the past, European fashions, especially Italian fashions, were followed closely in Japan. However, today many Japanese prefer American fashions, in particular, casual apparel. Sports-related products such as T-shirts, sweat suits, and clothing with professional sports team logos are particularly popular, and so are jeans, outdoor wear, and any items with a casual, uniquely American look. Individuals in the 15–25-year-old age group follow U.S. fashion trends closely. However, women’s wear and children’s clothing wear in the United States are not gaining popularity quickly and are facing difficulties in the Japanese market.

A other trend in the Japanese market, and indeed in all sectors of business, is the growing tendency of consumers to demand “value.” Consumers are noticing that their prices are much higher than those of comparable industrialized countries (Japanese consumer prices average 40 percent higher than those in the United States). Consumers still want high quality but are also demanding lower prices.

**Growth Projections.** According to the U.S. Department of Commerce International Trade Administration, apparel was the thirteenth best prospect industry sector in Japan for U.S. exporters in 1998. Analysts predict that the overall Japanese economy, which has been in recession until recently, will improve, but consumers are likely to be more cautious about spending money. This is in line with the growing trend toward “value.” The apparel market is expected to continue growing at 3 percent, but import growth is expected to increase. Japan has a very high level of receptivity to U.S. goods, not much local and third country competition, and almost no market barriers to entry. For Gap Inc., this indicates a favorable environment. However, the distribution system in Japan is the main obstacle to market entry and may pose major problems. The most promising subsector in the apparel industry for 1995 is men’s and women’s wear.
**Business Environment.** The domestic market is very competitive, and consumers are highly brand conscious. Longstanding, close-knit relationships between individuals and firms are very important in business operations. Local business practices are very traditional and foreign company participation is not considered important. A long-term approach is essential for U.S. companies in Japan to develop the necessary business relationships and show a willingness to contribute to the local business community.

**Business Attitude Toward the U.S. and Exit/Entry Barriers.** Japan has a positive attitude toward U.S. suppliers, and many U.S. companies have established reputations in Japan for high-quality, reasonably priced products. However, it is still proving difficult for some U.S. companies to overcome traditional Japanese attitudes toward foreigners as being “outsiders.” In the past, Japanese laws and regulations prevented many U.S.-based companies from entering Japan after World War II. The result has been little interaction until recently, and Japanese companies are hesitant to trust American firms. Officially, Japanese government policy is to promote imports and international business interaction, but traditional business attitudes are making this difficult.

It is also difficult for many U.S. companies to be accepted as business partners by Japanese companies that are bound by keiretsu ties that prevent them from doing business with non-keiretsu companies. If a Japanese company that is part of the country’s keiretsu is qualified in a particular business area, it will be chosen over a U.S. company. This is a significant barrier to market entry in Japan.

The most difficult obstacle for U.S. companies to overcome in Japan is the traditional distribution system. The keiretsu system controls many of these distribution networks and long distribution channels in which all participants must purchase from and sell to each other. This makes it very difficult for U.S. companies to get into a distribution system.

**Competitors and Substitutes.** Competition in the apparel industry comes mainly from low-cost Asian companies that also have the advantage of easy access to Japanese markets. However, U.S. brand image is very important and Asian products are considered low quality. European companies provide some competition, but this is mainly in the area of high-end brand name and designer clothing. Japanese companies’ competitiveness is eroded by the high manufacturing costs resulting from the strong yen.

Substitutes in the form of low-price discount retailers are becoming increasingly prevalent in Japan. They could pose a threat to higher-priced apparel stores such as The Gap.

**Government Regulation and Controls.** There is an incredible amount of government regulation in the Japanese business environment. This is mainly in the form of licenses, permits, and approvals that are required to do business. These licenses often take a long time to process and are somewhat of a barrier to market entry. In addition, “administrative guidance” papers, which are informal edicts issued by government officials to companies, are used to control foreign companies and restrict market entry. Although the Japanese government has removed most of the legal and administrative restrictions on for-

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**EXHIBIT 1**

**NET SALES (IN U.S.$)**

<table>
<thead>
<tr>
<th>Year</th>
<th>Net Sales (in U.S.$)</th>
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EXHIBIT 2
NET EARNINGS (IN U.S.$)

<table>
<thead>
<tr>
<th>Year</th>
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<td>534</td>
</tr>
<tr>
<td>1998</td>
<td>825</td>
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As Gap Inc. continues to expand into the foreign markets, it should consider several options to reduce costs and thereby increase profit. First, because Gap Inc. does not produce or procure merchandise in any of the foreign markets it is currently in, establishing free-trade zones in those countries might help increase profits by temporarily reducing duty and VAT costs, and no duties would be paid on extra merchandise. Second, attention should be paid to centralizing advertising to reduce cost. Third, the problems associated with sourcing from so many different regions should be considered and ways found to correct them. Finally, Gap Inc. should seek ways to take advantage of the many free-trade agreements that recently have been signed.

eign business activities in Japan, anticompetitive and exclusionary business practices still exist at lower levels of government. However, the government is actively seeking ways to increase foreign investment and imports.

CONCLUSION