

As Gap Struggles, Its Analytical CEO Prizes Data Over Design

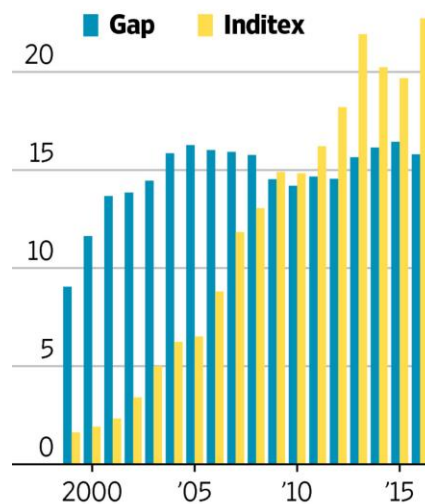
Khadeeja Safdar, Nov. 27, 2016 4:41 p.m. ET

Before he stepped into the role of chief executive at Gap Inc. in February 2015, company veteran Art Peck believed he had hit upon one major problem at the slumping apparel maker: Its creative directors had too much say over everything. By the time Mr. Peck took the top job, the creative director of the retailer's Gap brand had already been dismissed. A few months later, the company's Banana Republic chain eased out its creative head and eliminated the position. The 61-year-old CEO is blunt in his criticism of the industry's long fascination with creative executives who are given broad powers to set the overall image of a brand. "We have cycled through so many, and each has been proclaimed as the next savior," he said. In the end, they were "false messiahs."

Faded Glory

Gap's net sales have been stagnant for the past decade.

\$25 billion



Source: Thomson Reuters

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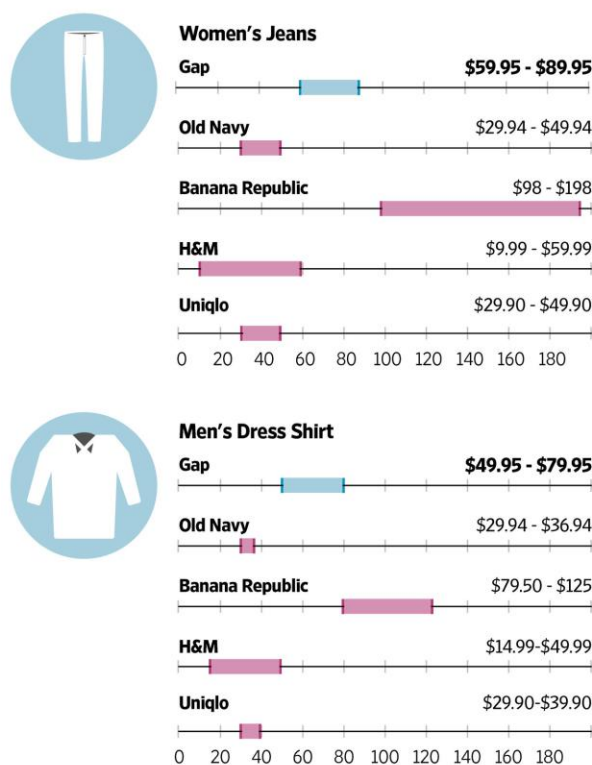
Under Mr. Peck, a former partner at Boston Consulting Group who arrived at the company in 2005, Gap Inc. has instead put operational executives in control of its major brands, including Old Navy. It has also expanded the role of outside vendors—some of which have their own design teams. Mr. Peck favors a model in which things are more decentralized. Brand merchants, who serve as collection editors, are no longer involved in every product category. Some items, like men's dress shirts, can be stamped out by a foreign supplier without approval from a head designer. He is also pushing executives to pay more attention to Google analytics and market-research data to monitor consumer tastes. "There is now science and art, and they can come together," said Mr. Peck in an interview.

The moves are part of an attempt to save an iconic apparel company from fading into extinction. For decades, its flagship Gap stores ruled America's malls and dictated the nation's casual aesthetic with its khakis and white tees. Nowadays, many millennials aren't willing to pay \$80 for a pair of bluejeans, forcing the brand to rely heavily on sales and markdowns. Meanwhile, wardrobe basics have evolved since Gap's heyday, with many customers swapping out denim for yoga pants. Chains such as Uniqlo and Hennes & Mauritz AB's H&M are producing similar items, but at lower price points. Gap is even getting squeezed by its own sister brands, as Banana Republic chases a more affluent crowd and Old Navy woos the frugal. "Gap needs to be remade in a way that's relevant," Mr. Peck told a group of investors in September.

Gap Inc.'s market value has shrunk to about \$10 billion, from roughly \$40 billion at its 2000 peak. Revenue has stalled at about \$16 billion—flat from a decade ago. Last year, Mr. Peck told investors that spring 2016 was "no excuses moment." But results have continued to disappoint. Earlier this month, the company reported its seventh straight quarter of declining sales, with Gap and Banana

An Awkward Fit

Gap isn't able to command a premium for basics, and it lacks the low-cost advantage of other brands — including sister chain Old Navy



Source: Company websites

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Gap and other traditional U.S. apparel companies fell behind. Mr. Drexler was forced out in 2002 after 24 straight months of same-store sales declines. Since then, the retailer has cycled through a series of CEOs and creative heads, and each has failed to arrest the slide. Inditex SA, the Spanish company that owns Zara, has been a particularly nimble competitor. Today, the fast-fashion chain—with its constantly rotating offerings—is the world's biggest apparel retailer by sales and is now valued at roughly \$100 billion, or more than 10 times Gap Inc.'s market capitalization.

“A genetically superior breed of fish has been introduced into the gene pool,” said Ivan Wicksteed, Old Navy's former marketing chief who departed from his role earlier this year. “Gap has sat on the sidelines and watched fast fashion eat its lunch.” With the rise of online shopping, the retailer's scale—it still has about 3,700 stores around the globe—has also become a burden. The company is “simply too large in the new normal where physical distribution has become a liability and uniformity is no longer ‘cool,’ ” said Nomura analyst Simeon Siegel in a research note. Earlier this year, Mr. Peck said he was open to the idea of selling some products through Amazon.com Inc., but he hasn't followed through. When a recent fire destroyed millions of Gap and Banana Republic products at a distribution center in New York, Stifel analyst Richard Jaffe called it a “fortuitous reduction in inventory.” The flagship brand has even become a target for pop-culture derision. In the 2011 movie “Crazy, Stupid, Love,” the character played by Ryan Gosling goes shopping with his frumpy friend and implores him to “be better than the Gap!”

Republic posting the worst results. Shares of the company have fallen by more than a third since he took over, to about \$26. “If I have to self-critique, I may have underestimated the amount of time” it would take to turn things around, Mr. Peck recently said.

In interviews, more than a dozen former and current executives said the company strains under the weight of bureaucracy. Some said Mr. Peck's initiatives haven't been drastic enough and his decision to promote company insiders to run its three major divisions, rather than bring in outsiders with fresh ideas, has failed to invigorate the retailer. In the 1990s, when former CEO Mickey Drexler famously predicted America's infatuation with a casual uniform, Gap was at the top of its game. Back then, according to former executives, merchants were guided by instinct, and planners adhered to the calendar with four seasonal collections. Creative teams enjoyed lavish travel budgets to scout far-flung places for inspiration. As consumer tastes shifted and rivals began offering similar merchandise at cheaper

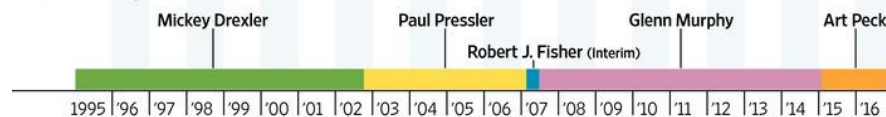
For years, the company has been studying rivals like Zara and Uniqlo, the chain owned by Japanese retailer Fast Retailing Co., according to former executives. But thus far, it has little to show for its efforts. In recent months, Gap and Banana Republic have both been touting fabric innovations—a concept made popular by Uniqlo. A \$98.50 pair of men’s wool pants at Banana Republic is advertised as stain and wrinkle resistant; a \$108 pair of men’s skinny jeans at Gap is made with stretchy fabric. “We see this as the beginning of a reinvention of active and ready-to-wear coming together,” Mr. Peck said. Unlike fast-fashion stalwarts, which continually buy small quantities of merchandise, Gap would buy inventory for most of a season at one time, former executives said. Unless a style was selling well, it was destined for a series of markdowns until the next large inventory purchase. Zara, by comparison, sends small batches of apparel to stores and waits for consumer reaction. Using real-time data, the company airlifts additional products to stores within days to meet demand. The chain is also known for few markdowns.

Faster Fashion

Inditex, the company that owns Zara, has overtaken Gap in market value and is now more than 10 times its size



CEOs of Gap Inc.



Note: 2016 data through November
Source: FactSet; Thomson Reuters

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Orders at Gap require corporate approvals, while Zara permits an employee or agent to authorize new stock on the spot, according to a supplier who makes garments for both companies. The Spanish retailer is “afraid of not making a quick decision,” whereas Gap is “more fearful of making the wrong decision,” said an executive at the shared supplier.

Former executives said Gap’s broader aversion to risk—from old-school supply-chain systems to a lack of fashion daring—has kept it behind. “There are not

many retailers with more resources than Gap to create the next trend,” said Rajiv Malik, who was vice president of global product operations at Gap Inc. until last year. “In this retail environment, you have to take risky bets to even have a chance.” To get items more quickly, Mr. Peck has shifted some manufacturing from Asia to the Caribbean. He also wants to stagger product releases throughout the year and shorten the time it takes for items to go from the drafting table to stores to take into account the most recent data trends. The CEO now encourages employees to share information across the company’s five brands, which also include activewear retailer Athleta and Intermix, a store concept that features of-the-moment designer fashions.

The Gap chain has copied some of Old Navy's processes, many of which were instituted under the brand's former president, Stefan Larsson. For instance, Old Navy, which now accounts for about 42% of revenue at the parent company, saves time and money by buying large quantities of fabric before deciding what to do with it—a strategy now being used at Gap. Mr. Larsson, who hailed from Sweden's H&M and led a turnaround at Old Navy, left in October 2015 and is now CEO at Ralph Lauren Corp. In April, Mr. Peck gave his job to Sonia Syngal, a Gap Inc. veteran who previously oversaw the company's supply chain. Product teams meet on a regular basis to compare notes—such as best-selling items and fabric innovations. Mr. Peck wants the company to “think like a portfolio and act like portfolio,” said Nancy Green, president of Athleta. There is a potential downside to so much togetherness. With its similar merchandise, Old Navy has cannibalized sales at Gap stores, according to some analysts. Gap, Old Navy and Athleta all sell yoga pants—but at different price points—turning a specialty item into more of a commodity.

“You knew what Gap stood for when Mickey Drexler was running it,” said Garrett Bennett, a retail consultant at Merchandising Metrics. “When you don't have a creative visionary leading a company, you can't really establish a consistent look over a period of time and reinforce the brand's purpose.” Mr. Drexler is chairman and CEO of privately held J. Crew Group Inc., which has seen slumping sales over the past two years. Recently the company began selling some merchandise through Nordstrom Inc. department stores. Several people who held creative roles at Gap Inc. said that even basic aesthetic decisions had become complicated. Collections needed signoffs from various management layers, and the final lineups ended up looking very different from their initial vision, these people said. “Gap is not a design-led company and thus I had very little say in what ended up in the store,” said Rebekka Bay, who left as the flagship brand's creative director in early 2015 when Mr. Peck took over.

Mr. Peck's new approach is about “taking out the voice of one creative head and allowing a creative ecosystem to exist,” said Wendi Goldman, chief product officer for the Gap brand. Some company alumni are circumspect, saying too many viewpoints can water down the product. “Anything that has to become a consensus is an equation for dilution,” said Todd Oldham, a former creative director at Old Navy. “Without a distinct point of view, you become like everyone else.” Mr. Oldham was fired in 2009 after he filed a lawsuit against Old Navy alleging it had breached a licensing agreement. The two parties reached an undisclosed settlement in 2013.

Executives still see the company as a cut above. Mr. Peck recently announced plans to ramp up marketing, including the first national TV ads for the Gap brand since 2014. Banana Republic is revisiting its catalog tradition. “I think the product is better than the business right now in Banana Republic and Gap,” said Mr. Peck on a conference call with analysts. “Not perfect by a long shot but better than our business.”

Many young consumers aren't convinced. “Gap's brand is not terribly cool, and it's overpriced,” said Andrew Martin, 24, a shopper from Los Angeles. “If I'm going to splurge on clothes, I would be so much more likely to buy things I think are cool.”

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