

The State of Fashion 2019



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Executive Summary

Global Economy

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MGFI

Foreword



Thomas Lohr

The State of Fashion 2019 marks the third year of an ongoing partnership between The Business of Fashion and McKinsey & Company, bringing analytical rigour and evidence to better understand the rapidly changing global fashion industry and providing an authoritative point of view on the state of fashion in the year to come.

Once again, our team of global experts has conducted fresh research and analysis to bring clarity and precision to a fragmented and complex landscape of countries, companies, categories and segments. Our research establishes a common understanding of the forces at work in fashion; sets out how well the industry is performing; and identifies where the top priorities, both business and creative are for 2019. Once again, we combine BoF's insider knowledge with McKinsey's global expertise and analytical rigour, and then survey more than 270 global fashion executives and interview many of the industry's thought leaders and pioneers.

The State of Fashion 2019 also includes the third read-out of our industry benchmark, the McKinsey Global Fashion Index (MGFI). Its database of over 500 private and public companies allows us to analyse and compare the performance of individual companies against their peers by category, segment or region. Now three years in, this is an unrivalled resource on which we continue to build.

The year ahead is one that will go down in history. Greater China will for the first time in centuries overtake the US as the world's largest fashion market. It will be a year of awakening after the reckoning of 2018 — a time for looking at opportunities, not just challenges. In the US and in the luxury sector it will be a year of optimism; for Europe and for struggling segments such as the mid-market, optimism may be in short supply. Far-sighted companies will make bold moves in automation and AI, and will disrupt themselves before others do it for them. Consumers will make or break brands based on trust. And global economic and political trends hover over the whole picture.

In short, it's going to be a bumpy ride. But whatever your role — from boardroom executive to start-up founder to informed consumer — read on, and we'll cushion the impact and tell you everything you need to know about the state of fashion in 2019.

— Imran Amed & Achim Berg

Contributors



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As founder, editor-in-chief and CEO of The Business of Fashion, Imran Amed is one of the fashion industry's leading writers, thinkers and commentators. Fascinated by the industry's potent blend of creativity and business, he began BoF as a blog in 2007, which has since grown into the pre-eminent global fashion industry resource serving a five-million-strong community from over 190 countries and territories. Previously, he was a consultant at McKinsey in London.



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As global senior expert in McKinsey's Apparel, Fashion and Luxury Group, Saskia Hedrich works with fashion companies around the world on strategy, sourcing optimisation, merchandising transformation, and sustainability topics – all topics she is also publishing about regularly. Additionally, she is involved in developing strategies for national garment industries across Africa, Asia, and Latin America.



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After a year of reckoning — time for an urgent awakening

For fashion players, 2019 will be a year of awakening. The ones who will succeed will have to come to terms with the fact that in the new paradigm that is taking shape around them, some of the old rules simply don't work. Regardless of size and segment, players now need to be nimble, think digital-first and achieve ever-faster speed to market. They need to take an active stance on social issues, satisfy consumer demands for ultra-transparency and sustainability, and, most importantly, have the courage to "self-disrupt" their own identity and the sources of their old success in order to realise these changes and win new generations of customers.

They also need to invest in enhancing their productivity and resilience, as the outlook is increasingly uncertain. External shocks to the system continue to lurk around the corner, and growth cannot be taken for granted: the McKinsey Global Fashion Index (MGFI) forecasts growth of 3.5 to 4.5 percent for 2019, slightly below 2018 growth, predicted at 4 to 5 percent. Optimism can be found only in pockets, notably in North America and in the premium and luxury segments, aided by their strong performance in 2018. The majority of executives in the remaining segments and geographies are pessimistic, citing "dealing with volatility, uncertainty and shifts in the global economy" as their primary concern for the year ahead. Risks of trade disruptions and slowing economic growth, even in key growth markets in Asia, could undermine global growth prospects, as could uncertainty over other major events such as Brexit or the possible onset of a global economic slowdown.

All this comes against a backdrop of a fashion industry that turned a corner in 2018, with increased growth justifying the optimism

expressed in last year's global fashion survey. But even with this more positive backdrop, executives are now fully acknowledging the changing nature of the industry, using words such as "changing," "digital," and "fast" to describe it. In a year of reckoning, for which the McKinsey Global Fashion Index predicts growth of 4 to 5 percent for 2018 (up from 2.5 to 3.5 percent in 2017), fashion players have begun to look proactively at opportunities rather than just focusing on challenges ahead.

According to McKinsey FashionScope, Greater China is expected to overtake the US as the largest fashion market in the world in 2019.

However, recovery continues to be unequal, with most of the growth coming from luxury and emerging markets in Asia. According to McKinsey FashionScope, Greater China is expected to overtake the US as the largest fashion market in the world in 2019. Mid-market companies and mature economies continue to lag, with the exception of North America, which saw higher than expected growth supported by an expansive fiscal policy. Meanwhile, polarisation persists: the top 20 companies in the industry account for 97 percent of economic profit, while an increasing proportion of publicly-traded fashion companies struggle to create any economic value. The prizes for those who can adapt may be greater than ever — but so are the penalties for those who fail.

For fashion players, 2019 will be a year of awakening. The ones who will succeed will have to come to terms with the fact that in the new paradigm that is taking shape around them, some of the old rules simply don't work.

Sunny intervals — but storms ahead

After strong performance in 2018, the industry will slow slightly in 2019. The McKinsey Global Fashion Index predicts industry growth of 3.5 to 4.5 percent in 2019 compared with a 4 to 5 percent estimate for 2018. The weaker forecast reflects economic predictions for slightly slower global growth and potential disruption to trade relationships. We see Latin America, Middle East and Africa and Russia experiencing more economic and political challenges, which will likely dampen consumer spending. Europe is facing a slowdown and US growth may have peaked in 2018. Emerging Asia Pacific countries and much of emerging Europe, on the other hand, will continue to see strong spending growth with more global players entering these markets.

The caution in the economic outlook is also reflected in our BoF-McKinsey State of Fashion Survey, with 42 percent of respondents expecting conditions to become worse in 2019. Dealing with volatility, uncertainty and shifts in the global economy are seen as the top challenges for the third straight year. This pessimism could be driven by fears of an accelerating trade war as China and the US react to each other's tariffs, uncertainty over how Brexit will play out (still unclear as we go to press), or just a feeling that a 10-year boom is now overdue to tip into recession.

Over the past year, the global fashion industry has reached new heights. We see growth of 4 to 5 percent in 2018, slightly ahead of our projections for 2018, and a considerable uplift on the 2.5 to 3.5 percent seen in 2017. Better performance has been driven by strong demand for luxury and value brands, sales growth in the US amid tax cuts and growth in emerging markets. However, as we describe in the McKinsey Global Fashion Index, this recovery has been polarised. Most of the economic gains have accrued to the top 20 “winners,” most notably in the luxury segment, while a growing number of players are struggling to create economic value.

Still, better industry conditions on aggregate have brought an overall change in attitudes. Now used to uncertainty after living with it for so many years, in 2018 fashion executives have begun to think less about survival and much more actively about their strategic agenda. When asked in the BoF-McKinsey State of Fashion Survey to describe the industry, the word that comes to the minds of most executives (34 percent) is “changing.” The second and third most common words are “digital” and “fast.” The implication is that change has become a key priority among industry leaders, with a particular focus on digital and speed-to-market.

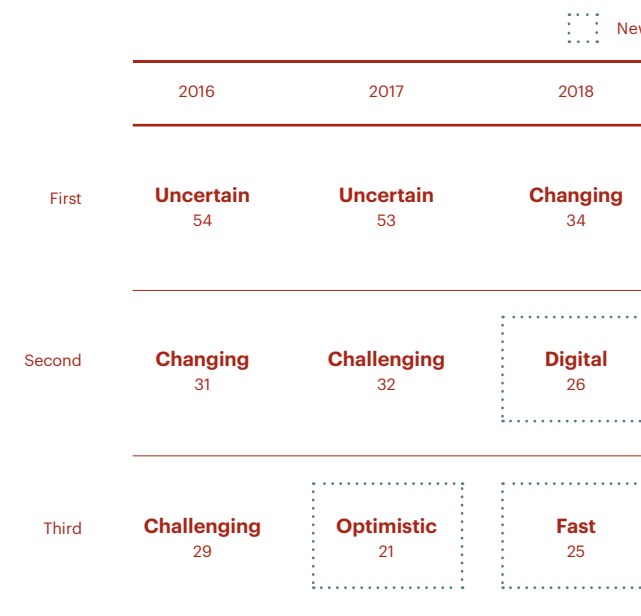
Much of emerging Europe will continue to see strong spending growth with more global players entering these markets.

The attitudes of executives also reflect evolving consumer behaviours that are forcing industry players to “self-disrupt” (the #1 trend identified by executives for 2019.) Footfall in the physical environment continues to decline, which is driving the need for brands and retailers to develop their omnichannel strategies. Social media has an increasingly important voice in dictating consumer demand, and it is helping small brands grow explosively. Across the industry, speed-to-market and responsiveness to consumer needs are becoming critical success factors.

When asked to reflect on the importance of the trends we predicted in last year's State of Fashion report, executives identified technology-related issues as their top four choices. Consumer shifts enabled by technology were particularly salient, with “mobile obsessed” cited as the most important of the trends we predicted. The second- and third-most important are “platforms first” and “start-up thinking,”

Executives describe 2018 with the words “changing,” “digital,” and “fast”

Exhibit 1:
Top 3 words to describe the industry
Top 3 words; % of respondents who mentioned word, n=274

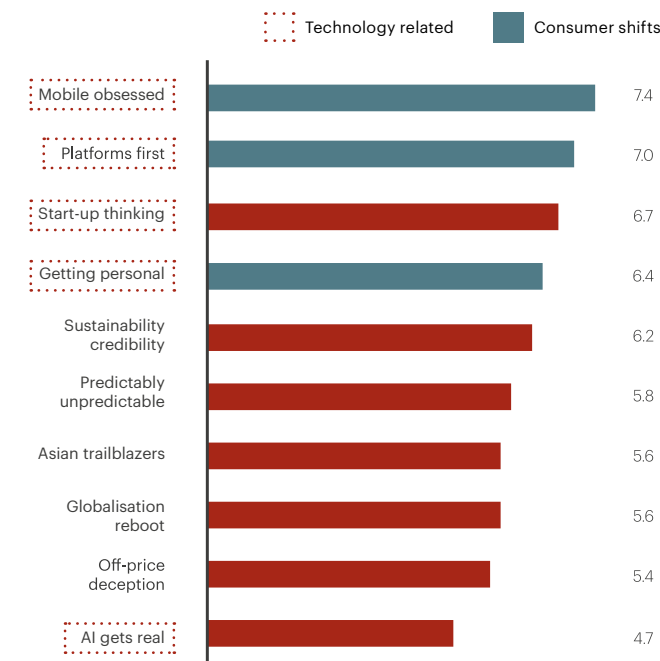


Question: What are the 5 adjectives you would use to describe how you feel about the fashion industry in 2018 so far?

Source: BoF-McKinsey State of Fashion Survey

Executives generally viewed consumer shifts enabled by technology as the most important trends in 2018

Exhibit 2:
Perceived impact of 2018 trends
Average rating of respondents (1-10)



Question: Looking back at 2018 so far, how much have the following trends impacted your business?

Source: BoF-McKinsey State of Fashion Survey

Volatility, uncertainty and shifts in the global economy is still foreseen as the industry's #1 challenge

Exhibit 3: Main challenges for year ahead

	2017	2018	2019
1 st	Dealing with volatility, uncertainty and shifts in the global economy	Dealing with volatility, uncertainty and shifts in the global economy	Dealing with volatility, uncertainty and shifts in the global economy 15% of respondents
2 nd	Sales and profitability growth	Competition from online and omnichannel	Competition from online and omnichannel 13% of respondents
3 rd	Competition from online and pure-play players	Value chain improvement and digitalisation	Speed of changing consumer preferences 7% of respondents
4 th	Supply chain improvement	Decreasing foot traffic and offline retailing pressure	Need to achieve greater sustainability and transparency 7% of respondents

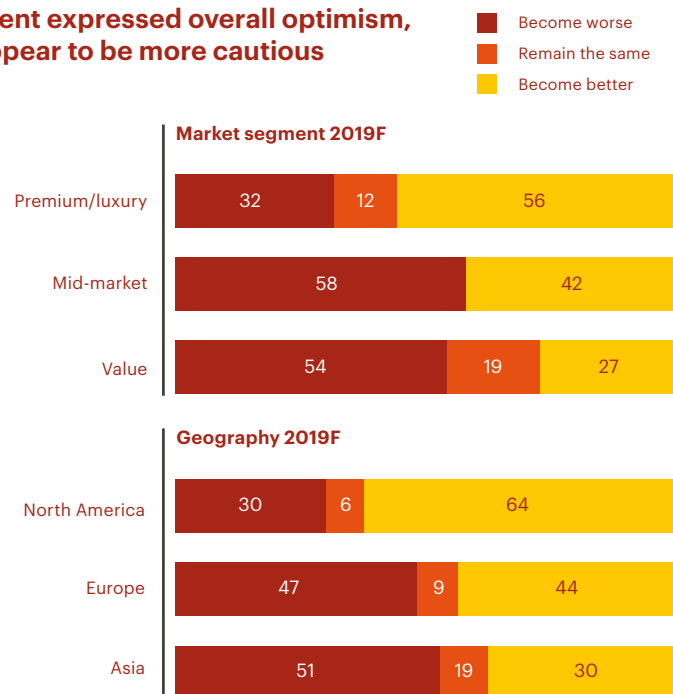
Question: What do you think will be the single biggest challenge for the fashion industry next year?

Source: BoF-McKinsey State of Fashion Survey

While the premium/luxury segment expressed overall optimism, value and mid-market players appear to be more cautious

Exhibit 4: Outlook for industry conditions in 2019

% of respondents



Question: How do you expect conditions for the fashion industry to develop over the course of the next 12 months?

Source: BoF-McKinsey State of Fashion Survey

again highlighting companies proactively dealing with digital disruption in the fashion system.

We were surprised to find artificial intelligence (AI) less highly ranked. This shift may not have reached critical mass in 2018, but we predict it will continue to affect the industry in 2019 and beyond. Players including Amazon, Alibaba, Myntra and Stitch Fix have made progress across various areas of the value chain and others will follow suit. Ananth Narayanan, chief executive of Myntra, remarked that, “for curation and assortment, we are using a lot more data science to tell what will sell. I think that could extend a lot more into manufacturing and the back-end system and we are doing parts of that already at Myntra.”

An increasingly important priority is sustainability and transparency, reflecting rising concerns on the part of consumers and companies about how to alleviate their impact on the environment. Sustainability, which for the first time breaks into our respondents’ list of the most important challenges, is evolving from a tick-box exercise into a transformational feature that is engrained in the business model and ethos of many recent success stories.

By geography, the most optimistic about the coming year are executives in North America. By segment, the most positive are executives from luxury brands, reflecting their strong growth trajectory in 2018. In all other regions and segments, executives are notably pessimistic, reflecting the potential challenges ahead.

Not surprisingly, executives are looking to invest where they see the most need to add value. For the third year straight, the top sales growth investment priority remains developing omnichannel capabilities. This reinforces our perception that executives have finally come to terms with the fact that the industry is digitising, but are not yet satisfied with their own response. Some 54 percent of the BoF-McKinsey State of Fashion Survey respondents said increasing omnichannel integration (alongside

investing in e-commerce and digital marketing) is their number one priority for 2019 for the third year running.

From an operational perspective, another persistent trend has been the desire to address cost structures at an organisational level, including efforts to improve productivity. This remains a key priority in 2019 with 29 percent of the BoF-McKinsey State of Fashion Survey respondents saying they wish to “review organisational structures and focus on increasing employee productivity.” This underlines the need to adapt operating models and create a more agile organisation that can thrive in the digital world.

In 2018, fashion executives have begun to think less about survival and much more actively about their strategic agenda.

Overall, the fashion industry continues to hover in a state of flux and the fortunes of individual players can turn with frightening speed. As our 10 trends indicate, new markets, new technologies and shifting consumer needs present opportunities but also risks. We predict that 2019 will be a year shaped by consumer shifts linked to technology, social causes and trust issues, alongside the potential disruption from geopolitical and macroeconomic events. Only those brands that accurately reflect the zeitgeist or have the courage to “self-disrupt” will emerge as winners.

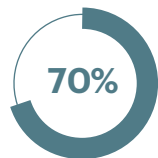
The State of

Fashion 2019

GLOBAL ECONOMY

- 01. **Caution Ahead**
- 02. **Indian Ascent**
- 03. **Trade 2.0**

Downward movements in key economic indicators and other potentially destabilising forces will conspire to create a more cautious mood. With the possibility of a global economic slowdown by 2020, companies will turn more prudent and start to look more aggressively into opportunities to boost productivity compared to previous years.



Percentage of survey respondents that were concerned about the overall global macroeconomic outlook in 2019.

- 02. **Indian Ascent**

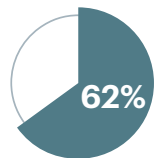
India becomes a focal point for the fashion industry as its middle-class consumer base grows and manufacturing sector strengthens. Fashion players must redouble their efforts in this highly fragmented and challenging market where an educated and tech-savvy demographic rub shoulders with the poor and upwardly mobile.



Projected number of smartphone users in India by 2022, 2.3x the usage in 2017.

- 03. **Trade 2.0**

All companies will need to prepare contingency plans to face a potential shake-up of global value chains. On the one hand, the apparel trade could be reshaped by new barriers, trade tensions and uncertainty and, on the other hand, by new opportunities from growing South-South trade and the renegotiation of trade agreements.

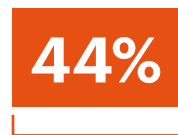


Percentage of survey respondents that believe changes in trade policy will pose potential risks to global economic growth (Q2 2018 sentiments, +8% from Q1).

CONSUMER SHIFTS

- 04. **End of Ownership**
- 05. **Getting Woke**

The lifespan of the fashion product is becoming more elastic as pre-owned, refurbished, repair and rental business models continue to evolve. Fashion players will increasingly tap into this market to gain access to new consumers seeking both affordability and a move away from the permanent ownership of clothing.



Percentage of survey respondents that believe the pre-owned business model will be more relevant in 2019 than in 2018.

- 05. **Getting Woke**

Younger generations' passion for social and environmental causes has reached critical mass, causing brands to become more fundamentally purpose driven to attract both consumers and talent. Consumers from some, but not all markets will reward players that take a strong stance on social and environmental issues beyond traditional CSR.



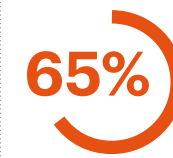
The number of times the word "feminist" is forecast to appear on retailer homepages and newsletters in 2018 compared to 2016.

- 06. **Now or Never**
- 07. **Radical Transparency**

In the mobile consumer journey, the gap between discovery and purchase has become a pain-point for a more impatient fashion consumer, who seeks to purchase exactly the products they discover, immediately. Players will focus on bridging this gap through shorter lead times, improved availability of advertised products and new technologies such as visual search.



In 2018, customers of Amazon in the US expected deliveries within 24 hours, as opposed to a 9-day delivery time expectation in 1995.



Percentage of survey respondents that cited "consumer needs for trust in product authenticity and creative originality" in their top 5 trends for 2019; ranked 2nd out of 12.

FASHION SYSTEM

- 08. **Self-Disrupt**
- 09. **Digital Landgrab**
- 10. **On Demand**

Traditional brands are beginning to disrupt their own business models, image and offering in response to a new breed of small emerging brands that are accelerating thanks to decreasing brand loyalty and a growing appetite for newness. We expect more brands to follow suit on this path of self-disruption, which will have a significant impact on their operating models.



Top ranked trend that fashion executives predict will shape the fashion industry in 2019, included in top 5 by 80% of respondents.

- 09. **Digital Landgrab**

As the race to be the platform of choice for both customers and brands intensifies, e-commerce players will continue to innovate by adding profitable value-added services. Whether through acquisitions, investments or internal R&D, those players who diversify their ecosystem will strengthen their lead over those who remain pure players relying solely on retail margins.



Revenue CAGR of fashion e-commerce retailers over traditional fashion retailers from 2013 to 2017.

- 10. **On Demand**

Automation and data analytics have enabled a new breed of start-ups to achieve agile made-to-order production. Mass players will begin to experiment next, responding more rapidly to trends and consumer demands, achieving just-in-time production and reducing overstock and making short, small-batch production cycles the new norm.



Aspiration level for a shift to nearshoring will double between 2018 and 2025.

Global Economy



01. CAUTION AHEAD

A potential turn in the economic cycle is prompting concern among industry executives over prospects for the coming year. Following a prolonged period of growth and rising costs, strategic priorities for the subsequent period are likely to focus more on being nimble and boosting productivity.

While last year was characterised by cautious optimism in the face of uncertainty, this year various indicators point towards clouds on the horizon which could somewhat dampen global economic growth prospects. Global growth has averaged above 2.5 percent in the years since the financial crisis, but there are signs of a plateau.¹ Additionally, after a long period of accommodative monetary policy, the US Federal Reserve and other central banks are starting to raise interest rates, increasing the cost of borrowing for many companies and consumers. The European Central Bank is also signalling tightening monetary policy in the coming months, increasing the chance that global economic growth could start to slow.

Forecasts from the World Bank, IMF and OECD predict slower growth in developed markets through 2020, and a flattening of the growth curve in developing markets. Looking ahead to 2019, there are signs that Europe, Latin America and the Middle East could be most vulnerable to a deceleration. The US and China could also face a slowdown, with fears of a potential bubble in the former, and trade dynamics could impact consumer spending and fashion sector growth in both.

In addition, advanced economies are struggling to lift labour productivity, which has remained basically flat over the past eight years, dampened by after-effects from the financial crisis, while significant advances in automation and digitisation come with lag effects and transition cost. China and India have bucked the global trend and continue to see sharp productivity increases, measured by GDP per person employed. (Productivity growth and increases in the number of employed people are the key drivers of economic growth.)

These official forecasts are also reflected in sentiment among industry leaders. In a survey of more than 1,000 international executives and chief executives across industries published by McKinsey in September 2018, some 41 percent expect global economic conditions to worsen, compared with 35 percent in June 2018 and just 15 percent in December 2017.² This sentiment echoes the views of the IMF, whose managing director Christine Lagarde said during a Bretton Woods Committee meeting in October 2018 that “It’s not just clouds on the horizon that we see, but some of the clouds have started opening up, and it’s a bit more than a drizzle.”³

None of this has gone unnoticed in the fashion industry. Executives view economic conditions as a potential challenge, citing it as the third biggest trend for 2019 in the latest BoF-McKinsey State of Fashion Survey. Forty-two percent expect industry conditions to worsen in 2019. Excluding respondents from North America and the luxury segment, which are the main pockets of optimism, the majority of executives are even more pessimistic about the year ahead.

“It’s not just clouds on the horizon that we see, but some of the clouds have started opening up, and it’s a bit more than a drizzle.”

The strong performance of the global economy over recent years has been accompanied by rising investments by fashion industry players. Sixty-eight percent of companies’ cost bases have risen over the past five years, while only 22 percent have seen a decrease. Average selling, general and administrative expenses (SG&A) were 36 percent of sales in 2017, compared with 34 percent in 2013, according to analysis from McKinsey’s Global Fashion Index. Priority investments in sales growth named for this year were omnichannel and e-commerce, developing CRM capabilities, improving in-store experiences and investing in brand building.

For costs of goods sold (COGS), on the other hand, the picture is more nuanced. Over the last five years, COGS to revenue increased by 0.5 percentage points or more for 43 percent of companies in the MGF I and by over 2 percentage points for 25 percent of companies, often due to markdown pressure.

To offset the impact of slower growth and rising costs, companies need to set a strategic agenda to boost productivity over the coming

period. Several companies have already taken steps, implementing cost reduction and restructuring programmes. As a result, SG&A ratios have become more fragmented, with leading companies seeing a slower rate of cost increase than laggards. Among companies to act are hosiery and bodywear specialist Woldford, which launched a restructuring programme in late 2017,⁴ J.Crew, which said in 2017 it aimed to cut costs and rebrand,⁵ and H&M, which said in 2017 that it was aiming to reduce costs by 5-6 percent.⁶ More recently, Under Armour announced plans to continue to focus and drive productivity in September 2018.⁷

Looking at the year ahead, 17 percent of respondents to the BoF-McKinsey State of Fashion Survey said they would focus more on improving costs rather than growing sales. The main cost improvement areas cited include reviewing organisational structure (11 percent increase compared to 2018), diagnosing end-to-end efficiency opportunities and reducing product assortment complexity. Still, the proportion of executives planning to focus on cost efficiency is not substantially higher than the 16 percent of respondents that said the same in the previous year, suggesting that, while executives are concerned about economic development, cutting costs is not yet a top priority on fashion executives’ agendas.

Executives view economic conditions as a potential challenge, 42 percent expect industry conditions to worsen in 2019.

Our “winners and losers” analysis in the McKinsey Global Fashion Index may serve as additional inspiration to take a step towards efficiency: on average over the past five years, firms in the top 20 percent of economic profit have seen significantly lower SG&A and COGS as a proportion of revenue (4 percentage points and 6

percentage points respectively), compared with those in the bottom 80 percent, suggesting a strong link between keeping costs low and a strong bottom line.

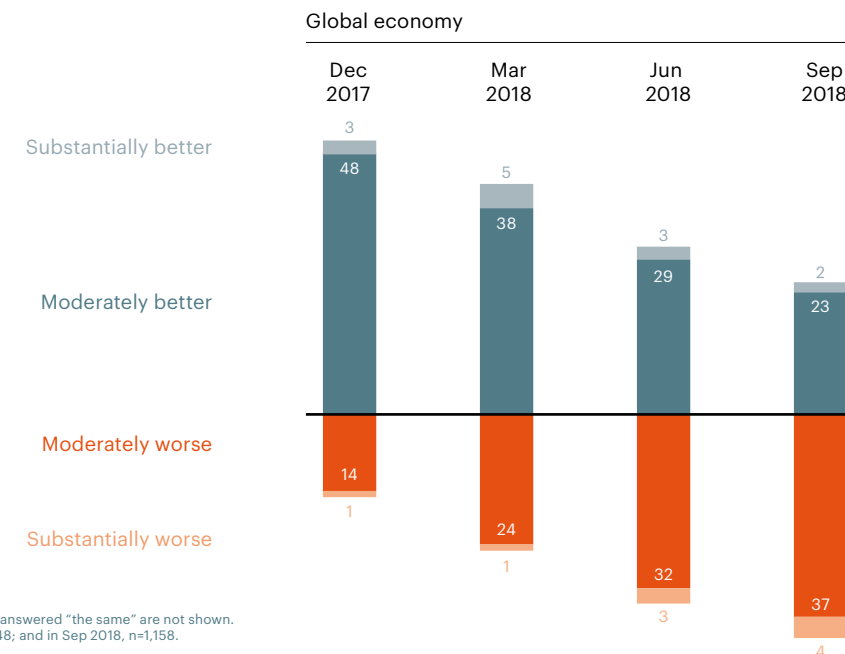
As the macroeconomic landscape shifts, we expect companies will seek to protect themselves from slower growth by implementing “shock proofing” measures. These will primarily be aimed at boosting productivity through greater efficiency and cutting costs. To ensure these interventions deliver sustainable benefits

over the longer term, fashion players should seek to couple productivity enhancements with necessary innovation efforts, such as automation of production, analytics-driven decision making, review of omnichannel footprint and reorganisation for better agility. Those that are successful are most likely to reap rewards in terms of outsized performance.

Among executives of all industries, there’s an increasing view that the economy will worsen

Exhibit 5: **Expected change in global economic conditions, next 6 months**

% of respondents



Respondents who answered “the same” are not shown. In Dec 2017, n=1,648; and in Sep 2018, n=1,158.

Source: McKinsey Economic Conditions Snapshot, September 2018

Joann Cheng

Chairman of Fosun Fashion Group & Lanvin



The chairman of the fashion group of Fosun International, an \$80 billion Chinese conglomerate which owns Lanvin, St. John Knits and Welford, talks about global trade tensions, China's slowing growth and future investment opportunities.

— by Casey Hall

but as long as our portfolio has [such diversity,] the impact can be mitigated.

BoF: How do you think Western luxury brands like Lanvin and St. John can enhance their appeal to Chinese consumers?

JC: China is quite a unique market and also very crucial for the luxury fashion business. Sometimes people think of Greater China as one business, [but] actually, in my view, you have different cities and different provinces across a very large geography, so if you handle China it's not only handling one market region. You also handle different cultures, different demands in the system, different tiers of cities.

However, one thing is true: Chinese consumers are becoming more international. They are more awakened; they've learnt self-expression. The young generation are digital natives; they are global citizens. Connecting better with our Chinese audience is one of the priorities for brands like Lanvin, St. John and Welford. We have to go digital and offer offline channels so people in China [can] use their smartphone to shop [in a seamless way.]

Also we need to create our brand narrative and tell the story in their own language and how that relates to our brand DNA. Of course, we need to optimise the product portfolio to reflect the consumers' needs, so product is key. Customised events and products will make our products more appealing to Chinese consumers. And we have to drive

the force on fast-changing social media to really integrate the multi-social [experience]. Finally, [we are focusing on] improving the brand shopping experience using O2O omnichannel.

BoF: At Lanvin, you've recently brought on a new chief executive. What do you see as his priorities to revive the brand?

JC: Yes, Jean-Philippe Hecquet is super strong. The first priority is to recruit the right design team to create appealing and well-balanced collections to reinterpret the brand DNA and the clothes in a powerful and modern way. Then we'll focus on the collections.

“For our portfolio, balance and diversity are very important. When I refer to diversity, it's not only a category diversification but also a geographic and demographic diversification... We're never able to omit all the risks, but as long as our portfolio has [such diversity,] the impact can be mitigated.”

In terms of the retail network, I think he will focus on growing the key markets, including Europe, yes, and Greater China. Another priority will be the store concept, so that we can keep delivering a consistent message in the brand expression. Digital is [central] to that so we need to accelerate brand digitisation, invest heavily on communication and the e-commerce platform. In terms of the culture and the people, I think it's quite clear that we need to bring back the confidence, the positive tones

and the winning spirit amongst teams. So, the whole organisational chart needs to support our future growth.

BoF: How will your investment scope and target strategy change in 2019?

JC: At Fosun Fashion Group we consider ourselves as the new kid on the block. Our strategy in both investment and operations could well be dynamic in view of the development of the whole group and the whole industry. However, whatever changes we make, it's a broader core vision that's consistent with what Fosun Group has been doing for years, which is to focus on the consumer lifestyle.

One of the keys for Fosun Group is happiness, so this has also become our consistently-applied strategy — around the happiness [aspect of] the consumers' lifestyle.

This interview has been edited and condensed.

India is increasingly a focal point for the fashion industry, reflecting a rapidly growing middle-class and increasingly powerful manufacturing sector. These, together with strong economic fundamentals and growing tech-savvy, make India too important for international brands to ignore.

Economic expansion is happening across Asia, but we expect that 2019 will be the year in which India will take centre stage. The country is being propelled by strong macroeconomic tailwinds and is predicted to grow 8 percent a year between 2018 and 2022. The Indian middle class is forecast to expand at 19.4 percent a year over the same period, outpacing China, Mexico and Brazil.⁸ As a result, India is set to move from being an increasingly important sourcing hub to being one of the most attractive consumer markets outside the Western world.

India's apparel market will be worth \$59.3 billion in 2022, making it the sixth-largest in the world, and comparable to the UK (\$65 billion) and Germany (\$63.1 billion), according to data from McKinsey's FashionScope. The aggregate income of the addressable population (individuals with over \$9,500 in annual income) is expected to triple between now and 2025.⁹ According to Sanjay Kapoor, founder of Genesis Luxury, an Indian luxury retail conglomerate, higher incomes are likely to create a whole new class of consumer: "We are moving on towards the 'gold collar' worker. It's a term that defines the well paid, highly paid professionals, who are happy to look

good, happy to feel good and are expanding the consumption of today."

Given these dynamics, it is little surprise that more than 300 international fashion brands are expected to open stores in India in the next two years. But India remains a complex market, which presents challenges as well as opportunities. The apparel business is still largely "unorganised," with formal retail accounting for just 35 percent of sales in 2016. Its share is likely to reach around 45 percent by 2025,¹⁰ still a relatively low proportion.

To build momentum around conventional stores, Indian players are innovating the retail experience. Retailers are leveraging technology to enhance the in-store experience with digital marketing displays and improved check-out. For instance, Madura Fashion & Lifestyle launched the "Van Heusen Style Studio," which uses augmented reality to display outfits on customers. Malls have increased their share of food service and entertainment.

The growth in the apparel sector is also being driven by increasing tech-savviness among consumers. Ten years ago, technology was for the few, with just five million smartphones¹¹ in a

country of 1.2 billion people and only 45 million using the Internet.¹² These figures have since increased to 355 million and 460 million respectively (2018) and are expected to double by 2021, when more than 900 million Indian consumers will be online.

E-commerce leaders are moving to AI-based solutions. "Personalisation and curation, based on personal taste will become a lot more important," says Ananth Narayanan, chief executive of Myntra, a fashion e-commerce player acquired by Flipkart in 2014. "It's not about having the largest selection, it's about presenting the most appropriate selection to the customer involved."

The supply side of the industry is equally robust, and the growth of textile and apparel exports is expected to accelerate. According to a 2017 McKinsey survey, 41 percent of chief procurement officers expect to increase their sourcing share from India.¹³ India's average

labour cost is significantly lower than China's and comparable with Vietnam's. There is also a high availability of raw materials (e.g., cotton, wool, silk, and jute), which enable participation in the entire fashion value chain.

Still, players looking to enter the Indian market should recognise several inherent challenges. First, India is a mosaic of climates and tastes. "If you break [India] up into four parts, i.e., north, east, south and west, North India is the only region which is going to have winter, where you have mild to severe winter for eight weeks," says Kapoor.

"Brands that are successful in India have understood that, how [Indians] consume, what colour they consume, what kind of designs work, what touch points and personalisation work may be very different from a consumer living in New York or Hong Kong," Kapoor adds. "Indian women have kept a lot of their traditional sensibilities alive



Brian Soko/Bloomberg via Getty Images

and you see a beautiful mix of both Indian and Western sensibilities across the spectrum.”

International companies considering an entry into India should heed this important message. Traditional clothing is still very much the default choice for women, making up an estimated 70 percent of women’s apparel sales in 2017. Appetite for Western styles is likely to increase, but it is expected that traditional wear will still account for a 65 percent market share by 2023.¹⁴

“We are moving on towards the ‘gold collar’ worker. It’s a term that defines the well paid, highly paid professionals, who are happy to look good, happy to feel good and are expanding the consumption of today.”

Another challenge is the low quality of India’s infrastructure, which continues to lag behind that of many other Asian countries. Nearly 40 percent of the Indian road network was unpaved as of 2016.¹⁵ Poor infrastructure can make last-mile delivery difficult. In addition, retail stock is also often below expectations.

However, there are signs of improvement. “We have two fantastic luxury malls coming up in Bombay at the Bandra Kurla Complex along with the convention centre,” says Darshan Mehta, founder and chief executive of Reliance Brands, which operates over 500 stores for international brands. “So there is a whole new fantastic retail ecosystem.”¹⁶

One sign of India’s challenges, and also an indication of latent demand, is the growing level of inequality in the country, which follows a broader global trend of rising income inequality.¹⁷ The gap between the top one percent of earners

and the middle class is at its highest level in 92 years.¹⁸ Another consideration is the possibility of corruption. According to Transparency International, India ranks 81st out of 180 countries on its Corruption Perception Index (versus China at 77).¹⁹ A significant number of licences is required for new entrants, so executives should beware of the potential for complicated negotiations.

Still, many brands are determined to take advantage of India’s blossoming growth. The majority are likely to choose one of three routes. First, players can partner with existing e-commerce platforms. This is most suitable for players with little brand awareness and with relatively low capital to invest, and offers a good way to test demand and customer preferences. Second, brands that have little local knowledge and are looking for fast entry can enter with a franchise model, developing brick and mortar retail spaces. Finally, players that have significant local knowledge and capital resources can create fully owned and operated stores.

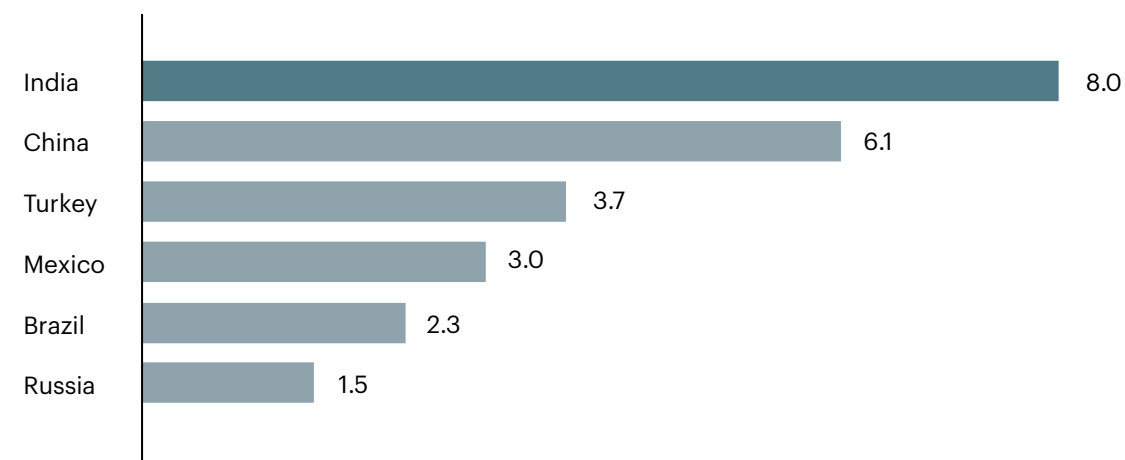
Indian authorities are certainly keen to promote investment. Relaxed FDI regulations (e.g., allowing 100 percent foreign-owned single brand retail operations), will likely lead to more overseas-originated activity through the value chain. We expect more outsourcing and more brand-owned stores without Indian partners in the years ahead. Most activity is likely to be focused on major urban centres, reflecting demographic trends, rising urban consumer spending power and improving infrastructure in those areas.

In short, the Indian market offers great promise. Despite structural challenges that include inequality, infrastructure and market fragmentation, we expect strong economic growth, scale and rising tech-savviness will combine to make it the next big global opportunity in fashion and apparel.

Of the top emerging markets, India’s GDP is expected to grow at the highest rate

Exhibit 6:
India powers ahead of other major emerging markets

Real GDP CAGR 2018-22 forecast, %



Source: Economist Intelligence Unit

Darshan Mehta

President & Chief Executive of Reliance Brands



The chief executive of the fashion division of Reliance Industries, India's largest private sector conglomerate with consolidated turnover of \$63 billion, talks about seizing opportunities in the fastest growing major economy in the world.

— *by Robb Young*

BoF: If you look at most five-year forecasts, growth projections for India's apparel market and the broader economy are quite impressive. But just how upbeat do you feel about business opportunities in 2019?

DM: Very upbeat. Last quarter our GDP grew 7.7 percent. So, we continue to retain the highest GDP growth in the world and everything prime minister Narendra Modi is doing — barring currency pressure — looks very good.

For a very long time, the Emporio Mall in Delhi became a bit of torch bearer of luxury [moving] out of five-star hotel lobbies into the mainstream consumer mindset. Ten years later we now have two fantastic luxury malls opening in Bombay so there is a whole new fantastic retail ecosystem. The Jio World Centre and Maker Maxity, both coming

out of within a kilometre distance to each other and Bandra Kurla Complex, are going to increase competition.

DM: I think mid- to the high-end because there is natural progression upwards. It's what I call [going from] the hundred dollars to the thousands of dollars.

“Every time you look at India through the Chinese lens you will not see [the opportunity] correctly. India is a whole different ball game. In India, it is not about the traditionally rich Indians — they shop all over the world. It is about the 999 others who are the customers of tomorrow.”

BoF: Indeed. One of the biggest challenges for fashion in India has been the lack of retail infrastructure. Is this changing? Could 2019 be a watershed year?

DM: Absolutely, I think in the same way that 2008 was. In 2008, the Emporio Mall started but the challenge with the Emporio was that unfortunately it was the same year the terrorist attacks happened in Oberoi and the Taj Hotel in Bombay. It took away some of the wind from the sails but nonetheless the Emporio marked a bit of a turning point. I think 2019 is going to be similar, we are going to see a very big change. Quest Mall in Calcutta is doing well; Palladium Mall in Chennai, early days, but you can see the traction is building; in Saket [an upmarket suburb of Delhi], the DLF mall is going through a complete overhaul [and then you have the new Mumbai malls so] we are going to see quite a bit of activity.

BoF: Which categories or segments do you think will reap the most benefits?

BoF: What we hear about most are the middle classes swelling resulting in a massive boost in more affordable fashion segments. Is it premature for us to expect the Indian middle classes to make a big impression in lower end brands?

DM: There are some categories where marketers and brands already reaped what we call the democratic dividend of the rich middle class. In a lot of these categories, individual players have worked very hard to create the [right] price-value equation. Fashion spending and trading up in the category should become a habit and it is, but I think the fashion industry overall has not done enough.

BoF: Despite the upbeat climate, India is still not an easy place to do business. What sort of pain-points worry you most?

DM: One of the biggest worries, which could become a substantial pain-point, is the forex situation. The economics of the Donald

Trump government and their approach [to] trade wars [are another concern].

The second is the rise of oil prices, especially given that India produces negligible amounts of its own oil and is largely dependent on oil imports. This is [worsened by] a rupee-dollar exchange rate which has eroded by close to six to seven percent since the beginning of 2018. From a consumer [spending] point of view, it's not always easy. You can either pass on the impact in volume shrink or you can have... deeper and more frequent discount on the product — both of which erode the margin.

The [other issue] is... the price value equation, which is getting substantially reset [due to the commoditisation of our sector by] the likes of Amazon and Flipkart. After the US, India is seen as possibly the next [market where this will happen], so that's a worry.

BoF: Let's talk more about that. There is so much dynamism happening in Indian e-commerce market; how bullish are you about e-commerce as an opportunity for a business like yours, which is skewed more toward luxury?

DM: Very bullish. We've created very clever software where all our stores' inventories are parallelly given digital exposure. Last year a significant portion of our brick-and-mortar sales [were driven by] online. It also doesn't [impair] the price-value equation because it is one inventory, one image and one price. For a place like India, which has pockets of

Executive Interview

wealth, I am able to have access to that because those pockets of wealth may still not be ready for a fully-fledged store, [but] the customers that exist in the town can still shop through my store.

BoF: Reliance recently upped its stake in Genesis Luxury Fashion, the Indian group that distributes brands like Bottega Veneta, Giorgio Armani, Michael Kors and Coach and has a joint venture with Burberry for the Indian market. Does Reliance have ambitions to become a luxury conglomerate along the lines of an Indian LVMH?

DM: We're certainly not trying to clone anyone else. When the Genesis opportunity came, we knew that they had a whole bunch of private equity players who were not so strategic in their approach. We saw a good opportunity when L Catterton wanted to exit and bought out all the other private equity players.

[Genesis Luxury founder] Sanjay Kapoor had created a good pool of talent, a good entrepreneurial ecosystem, some high-quality real estate, and a great brand portfolio, all of which sat well [with us]. We will never be predatory in nature, so having bought the first 40 percent [stake] our intention was to sit as a new partner along with Sanjay and his other partners to create more value.

BoF: Through Reliance's direct partnerships with brands like Zegna, Diesel and Bally, you have daily contact with many Western luxury executives. Generally speaking, how good of an

understanding do Western executives now have of the Indian luxury consumer?

DM: The singular mistake that they make is that the European mindset comes from a few centuries of inherited riches. In India we're now looking at the first wave of what I call first generation wealth, which spends very differently than inherited wealth. On the one hand, it is a very rich and powerful consumer movement because new wealth has an innate need to announce itself in many ways and fashion is clearly one of the ways. Yet, on the other hand, first generation wealth also has very sharp and recent memory of how that wealth was created and hence they spend differently because it is the wealth creator [himself or herself] who is spending it.

Second, because geographically we are juxtaposed to China, every time you look at India through the Chinese lens you will not see [the opportunity] correctly. India is a whole different ball game. In India, it is not about the traditionally rich Indians — they shop all over the world. It is about the 999 others who are the customers of tomorrow, who will find it too intimidating to go into the five-star hotel lobby or a gallery to shop there. So [former Burberry chief executive] Angela Ahrendts came and took the bold decision to set a Burberry opposite a Zara store [because] a woman coming out of the Zara store will feel less intimidated to go window shopping at the Burberry store.

This interview has been edited and condensed.



03. TRADE 2.0

Companies should make contingency plans for a potential shake-up of global value chains. The apparel trade could be reshaped by new barriers, trade tensions and uncertainty. However, there may also be new opportunities from growing South-South trade and the renegotiation of trade agreements.

Fashion is inherently sensitive to the policies and politics that shape cross-border trade. Recent talk of trade shifts between the US and some of its key trading partners has brought the issue to the fore. At the same time the axes of global trade are shifting, amid a surge in commerce between emerging economies in the Global South. The dynamics may lead to a rethink of sourcing and pricing strategies in the year ahead.

As 2018 ends, fashion companies find themselves in a cross current of trade-related news flow. A sharp rise in trade tensions between the US and other large economies seems set to increase costs for some players and increase the risk of disruption. At the same time, new trade agreements promise better trading conditions in certain instances.

In the US, the fashion industry accounts for 6 percent of imports but pays 51 percent of tariff receipts, so the tariffs issue is critically important.²⁰ In addition, with new tariffs coming into force on goods from China (including leather clothing, woven fabrics and wool yarn), there is a direct feed-through to the consumer. Companies such as Samsonite and Gap, which have large manufacturing operations in China, have said they plan to raise their consumer prices.²¹

Still, while the US and China are raising tariffs against each other, China is at the same time trying to make some imports cheaper. A Chinese government decision to cut import duties led LVMH to reduce prices by 3-5 percent in July on some items sold in China.²² In September 2018, China announced it would reduce tariffs for textiles and construction materials from 11.5 to 8.4 percent. Any reduction of tariffs usually must be offered to all countries equally under World Trade Organization rules, but China said US goods would still be subject to retaliatory tariffs.

Despite some of the positive developments in trade, the dominant theme over 2017 has been tightening of trade conditions between specific partners. For the G20 economies, there were \$74 billion of restrictive measures in May 2018, compared with \$47 billion in May 2017, a rise of 58 percent. Trade-facilitating measures, which include eliminating or reducing tariffs and simplifying customs procedures, meanwhile, fell from \$163 billion to just \$83 billion, a 49 percent drop.²³ Consumers are also noticing more gloomy trade sentiments: Google searches for the words "trade war," "trade tensions" or "tariffs" are at the highest level for at least five years, after growing by a factor of 10 this year.²⁴ The IMF, meanwhile,

predicts rising tariffs and the ensuing escalation of trade tensions could reduce global economic growth by 0.5 percent by 2020.

Perhaps unsurprisingly, executives are becoming concerned, and increasingly cite trade relations as a major worry for the coming year. McKinsey's Economic Conditions Snapshot in September was the second in a row in which trade policy was cited as a threat to global economic growth. 62 percent of respondents said it was their number one concern, up from 56 percent in March 2018.

63 percent of clothing designers and 55 percent of UK-based luxury goods makers are involved in exports and around 10,000 EU citizens are employed in the UK fashion industry.

A related issue is Brexit. A report by the UK Trade Policy Observatory suggests that, due to its high level of exports, reliance on international talent and dependence of raw materials from abroad, the UK textiles, apparel and footwear industry will be one of the hardest hit in terms of the impact of the UK leaving the European Union in March 2019. Some 63 percent of clothing designers and 55 percent of UK-based luxury goods makers are involved in exports and around 10,000 EU citizens are employed in the UK fashion industry. This explains why some 80 percent of respondents from Fashion Roundtable, a lobbying body formed to advise the UK government on matters relating to Brexit respondents, said that they felt Brexit would be bad for fashion in the UK and EU.²⁵ The prospect of Brexit has also started to impact fashion companies in other countries, particularly those being paid in sterling, which has fallen by around 12 percent against the Euro and 10 percent against the US dollar since the Brexit referendum in 2016.²⁶

Against this backdrop in Europe, the US fashion sector is also facing trade-related risks. According to the United States Fashion Industry Association's 2018 Fashion Industry Benchmarking Study, "protectionist trade policy agenda" in the US is the number one business challenge. Before 2017, it never ranked higher than eight. The US has announced tariff hikes on \$200 billion of goods from China including clothing. To highlight the proactive stance taken by some fashion players, American Apparel & Footwear Association (AAFA) at the end of May published a letter signed by 60 US labels (including Abercrombie & Fitch, Kate Spade, Levi Strauss, Macy's, Nike and Under Armour), arguing against increased taxation of Chinese textile and apparel imports.

Some fashion companies have begun to reconsider their presence in, and exposure to, countries where tariff barriers could further increase the cost of doing business. Wolverine World Wide, Puma and Steve Madden are among companies which stated they would consider moving production out of China.²⁷ Many companies had begun this process before the trade tensions mounted, but they cite the recent developments as a tipping point.

McKinsey's 2017 survey of 63 international chief procurement officers suggested that China's share of apparel exports is likely to continue falling, although trade tensions are just one of several factors driving this downward trend. Some 62 percent of respondents said they expected China's share of their companies' sourcing to decrease between now and 2025.²⁸

Trade data shows that these plans are now becoming reality: a marked and ongoing shift is underway in the apparel industry's sourcing markets, with new emerging markets increasing their share compared to China.²⁹

Still, while China might have passed its manufacturing zenith in apparel, it will likely remain an indispensable sourcing market for some

time to come, as described in our article "Global Value Chains in Apparel: The New China Effect" on page 34.

While concern over trade tensions is rising, there are also positive dynamics, with new agreements being put in place and new trade routes being developed. The EU has recently entered into new agreements including clothing and apparel with Canada, Mexico, Japan, Singapore, Vietnam and several countries from Eastern Europe. In September 2018, Canada agreed to join the United States and Mexico in a trade deal that will replace the North American Free Trade Agreement.³⁰

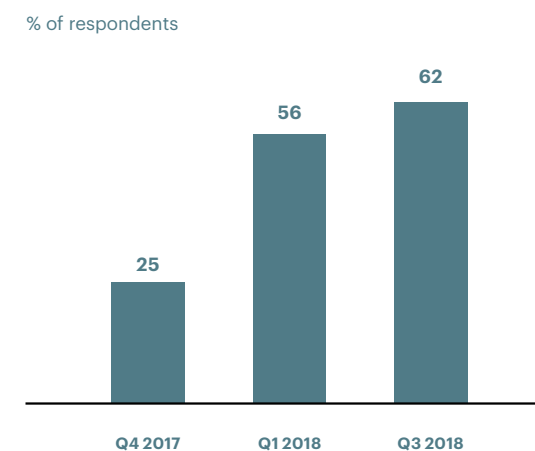
In addition, South-South trade is on the rise, amid expectations it will increase from around 25 percent of global trade at present to around 30 percent in 2030.³¹ Already, significant new relationships are emerging. China's expansive One Belt, One Road initiative, which involves large investments in the development of trade routes in the region, has the potential to play a large role in this development.

Finally, the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) and Regional Comprehensive Economic Partnership (RCEP) will enable more free trade between Asia and South America and within Asia. RCEP members export around \$405 billion of textiles a year (more than half of the global total) and import around \$115 billion, so the agreements will have a significant economic impact.

Overall, we expect trade-related forces will drive two key dynamics in 2019. Escalating trade tensions will see international brands rethink their sourcing strategies, perhaps to the benefit of countries involved in newly-negotiated trade agreements. A further increase in South-South trade, especially between emerging APAC countries, is likely. Fast fashion, which depends on short lead times, will need to find new strategies to maintain delivery speed

and production quality, for example through near-shoring or even on-shoring. Still, tough commercial decisions will be required in the face of tariffs in key consumer markets. Luxury players, especially those that derive most of their income from China or the US, may be required to choose between raising prices or managing squeezed margins.

Exhibit 7: **Belief that changes in trade policy will pose potential risks to global economic growth**



Source: McKinsey Economic Conditions Snapshot, September 2018

Global Value Chains in Apparel: The New China Effect

China's rapid rise has had an outsized impact on apparel trade. Now, new market forces are poised to upend trade again.

by Susan Lund, Mac Muir and Colin Britton

“Made in China.” Labels bearing these three words are tucked discreetly inside billions of articles of clothing hanging in Western closets, a sight so common that it became a symbol for globalisation itself. Many of the consumers who wear these garments every day think of China simply as the low-cost factory to the world — but those assumptions are outdated.

China's role in the global apparel trade is evolving, and because of its sheer scale, any shift in this role has ripple effects felt around the world. Today, China is pursuing ambitions to move into higher-value production by upgrading and modernising its apparel manufacturing capabilities, and wages are rising relative to the rest of the emerging world. At the same time, the burgeoning Chinese middle class is flexing its new spending power. China itself is now one of the world's biggest markets for fashion, and it can use its vast production capabilities to serve its own soaring domestic demand.

Although no other country has China's scale and footprint, the apparel trade is on the rise in other emerging economies, and recent technology advances in apparel manufacturing have even opened the door for some types of global production to take place in higher-wage countries, albeit in a more automated form. Below, we take a look at historical and more recent shifts in the global apparel trade and where it might be headed next, all of which affects not only sourcing decisions but also opportunities for brands and retailers to tap into tomorrow's markets.

Fabric and Apparel: The First Truly Global Value Chains

The history of trade and the history of the textile industry is one and the same. The merchants who plied the ancient Silk Road were an early model of the modern supply chain, bringing luxurious Chinese silks to Western Europe, where tailors turned them into lavish garments for the nobility. Seneca the Elder, a well-known orator of the Roman Empire, turned himself into the ancient world's fashion critic when he blasted the flimsiness of garments made of decadent foreign silk. In the 1600s and 1700s, India became the world's centre of manufacturing and trade as the British East India Company exported prized vibrantly coloured cotton textiles to wholesalers in London and Amsterdam.

Indian fabric flooded the European market to such an extent that it set off a protectionist backlash and was eventually banned in France and England, where thriving textile factories eventually became the seedbeds of the Industrial Revolution. Across the Atlantic, George Washington worried about the optics of attending his inauguration in an imported suit made by London's finest tailors so soon after the bloody fight for independence; his staff had to hustle to find an American-made outfit for the public swearing-in ceremony.³²

Textile production steadily migrated back from high-wage to low-wage countries in the 20th century until policy makers took steps to halt the flow. From the 1970s until 2004, the textiles trade was governed by the Multi Fibre Arrangement

(MFA), a system of quotas that limited bilateral imports of specific types of textiles and apparel. While it preserved some production in high-wage countries, the system also prevented any single developing country from dominating the textiles export market.

The main beneficiaries of the MFA were developing countries (such as Bangladesh) that might not otherwise have been able to compete with more productive low-wage countries such as China and India. Facing caps on its ability to export finished garments to advanced economies, China instead grew its textile industry by expanding up and down the supply chain.

As hundreds of millions of people have joined the middle class in the developing world, particularly in China, they are flexing their newfound spending power by expressing their own tastes through fashion. China is no longer simply the factory to the world. It is the world's fastest-growing consumer market, accounting for more than 18 percent of all final goods consumed.

The Rush to Manufacture in China

Restrictions imposed by the MFA began to be phased out in 1995, with textile quotas gradually pared back and then removed altogether in 2005. The share of production remaining in advanced economies shrivelled along with it, and the entire global textile industry began to reconfigure. The result was not a broad-based increase in production across much of the developing world, but a rush directly to China. In fact, some developing economies (including several in Africa) lost much of their share to China and saw their apparel manufacturing industries all but wiped out.³³

Across the advanced world, sourcing shifted to China to take advantage of low labour costs. This was particularly true for labels and retailers selling low-cost, low-margin items. These labels looked for the right combination of the lowest costs and the fastest turnaround times — and in most cases, they found the most competitive suppliers in China. As a result of this shift, consumers have come to expect low prices and accept clothing as a more disposable product. US consumers, for example, have seen the real price of apparel fall by 44 percent since 1995.³⁴

The map of global production was dramatically redrawn after 2005, with China clearly at the centre. In 1995, the United States was the world's leading apparel maker, turning out 13 percent of the world's textile output — a share that put it just ahead of China, which produced 12 percent. By 2017, China's share had ballooned to 47 percent, while the US share had shrunk to just three percent. Similar trends can be seen in other advanced economies; Italy, for example, saw its share of global production drop from eight to three percent over the same period, and Japan's dropped from 11 percent to just one percent.

The World's Fastest-Growing Market for Fashion

After the great shake-up of the late 1990s and early 2000s, it comes as a surprise to see that trade intensity in fabric and apparel (that is, the ratio of trade to overall global production) has actually declined. By 2017, the ratio of exports to output was one-quarter lower than it was in 2000.

Now, the apparel industry is in the midst of being reshaped once again — this time, by the power of new consumers. As hundreds of millions of people have joined the middle class in the developing world, particularly in China, they are flexing their newfound spending power by expressing their own tastes through fashion. China is no longer simply the factory to the world. It is the world's fastest-growing consumer market, accounting for more than 18 percent of all final goods consumed. Consider, for example, the explosive growth of

China's annual "Singles Day" — a one-day burst of e-commerce that hit an estimated \$25 billion in sales last year, topping 2016 sales by almost 40 percent and surpassing Black Friday and Cyber Monday in the United States combined.³⁵

More of what gets made in China is now sold in China instead of being exported. In 2005, China exported 71 percent of the finished apparel goods it produced; by 2017, that share was down to just 47 percent. This reflects increasing levels of consumption in China relative to the world and also echoes the results of a recent McKinsey & Company survey, which suggested that three-quarters of Chinese consumers reported preferring or somewhat preferring local brands of apparel and footwear over foreign brands.³⁶

This pattern is also beginning to play out in other emerging economies where incomes and prosperity are similarly rising, albeit on a smaller scale. In absolute terms, world trade in finished and intermediate textiles steadily increased from roughly \$365 billion in 1995 to \$860 billion in 2014. Since then, it has dipped back to \$740 billion — not because the market for fashion is shrinking, but because the traditional producers of textiles and apparel are able to consume a greater share of their output than ever before.

Rising Wages and a Move up the Value Chain

As China reaches a new stage of industrial maturity, it is continuing to develop its own domestic supply chains to meet rising domestic consumer demand. It is able to do this successfully because it has capabilities and capacity in every stage of textile production, from the cultivation of raw materials through fabric weaving, dyeing, finishing and sewing final garments.

Over the past decade, wages have climbed rapidly in China's more prosperous coastal regions, and a new generation has become less inclined than their parents to aspire to work in clothing factories. In response, China encouraged the development of inland textile suppliers, in effect using labour arbitrage within its own borders by shifting more

labour-intensive production to its inland provinces, where labour costs are much lower. Recently however, even inland wages are rising faster than the rest of the developed world, and Chinese manufacturing is becoming less competitive.

As China's exports have plateaued, other developing nations with lower wages are stepping in. Apparel exports from Bangladesh, Vietnam and Ethiopia have been growing by double digits annually since 2010. Turkey is also a major producer of clothing that is exported to Europe. In a 2017 McKinsey survey, 62 percent of chief purchasing officers at US and EU apparel companies said they were planning to diversify their sourcing away from China in the near- to medium-term. Bangladesh, Ethiopia, Myanmar and Vietnam emerged as the top countries where respondents expect to increase sourcing.³⁷

While a shift away from China is possible, it has not materialised on a significant scale as of yet. Capital-intensive cultivation of raw materials and weaving in particular is most likely to remain in place, since moving these industries would be costly and disruptive. Those parts of the value chain with the lowest switching costs and the highest labour intensity (typically the CMT stages) could move more easily. But while other developing countries do offer lower wages than China, the gap today is not nearly as large as the wage differentials that existed between China and advanced economies two decades ago when apparel manufacturing began to relocate en masse. Via the Belt and Road Initiative, China is using FDI, trade flows and infrastructure investment to build deeper connections with other producers and export markets across the developing world. In Ethiopia, for instance, China has invested more than \$10 billion in transportation and logistics infrastructure.³⁸

In addition to laying out a planned shift to Western and Central China, the nation's thirteenth five-year plan (covering the period from 2016 to 2020) calls for an upgrade of the textile industry. Its goals include making production more technologically sophisticated and more environmentally sustainable, offering higher-quality Chinese brands

to the world and improving quality.³⁹ This may involve shifting some production capacity away from apparel and into more complex, synthetic products such as automotive fabrics, disposables, cutting-edge protective wear and medical textiles. In short, China does not see its future in the lowest-margin parts of the value chain, acting as the factory to the world. It is moving up the ladder to more valuable production and broadening its focus beyond exporting finished goods to advanced economies.

New Technologies and the Need for Speed

In addition to the China effect, other factors are reshaping the apparel industry's global footprint, including the need to respond with agility to changing customer demand and the rise of new technologies.

Speed in production is critical to every fashion label and retailer — not just the purveyors of fast fashion. The metabolism of fast fashion has gotten even faster in the age of social media and big data. Taking this model to the extreme, some influencers (such as China's Becky Li, who shapes consumer demand among her millions of followers on WeChat and Weibo) are teaming with manufacturers to start their own fast-fashion lines. Even traditional labels are trying to cut down lead times before introducing new seasonal offerings, so they can get a better read on sales figures from the current season and tweak their line-ups accordingly, reducing unsold goods or designs that flop.

Taking full advantage of these insights requires rapid turnaround times in manufacturing and distribution, and it favours keeping the supply chain together and locating apparel manufacturing closer to the consumer to avoid shipping delays. In the survey of US and EU purchasing managers, 54 percent said that proximity to customers is becoming more important, and another 22 percent said it may be more important in the coming years.⁴⁰

New technologies such as robotics and 3D printing may enable companies to deal with these time pressures and offer customers greater

personalisation at the same time. Most garment and shoe manufacturing is not highly automated, but these technologies are maturing and overcoming some of their early limitations. Automation technologies should ensure that China remains a powerhouse of global apparel production even as its wages rise. In fact, some Chinese apparel makers are moving to automate quickly — not necessarily to save on labour but in pursuit of speed. The robust growth of China's consumer market should not only help to anchor its apparel industry but should also provide the incentives needed to invest in high-tech manufacturing.

A limited slice of production could even return to advanced economies, although in a very different form than the labour-intensive textile factories that closed in the 1990s and early 2000s. Adidas' widely known "Speedfactories" offer a glimpse into what the future could hold. Nike has pursued a similar strategy with the introduction of its Flyknit athletic shoes. Because they have two sewn pieces rather than the 37 pieces in its traditional running shoes, Flyknits can be made with a fully automated process, from the weaving of the fabric to the assembly of the shoe. As a result, Flyknits are mostly produced in Mexico, which has higher labour costs than Vietnam and Indonesia (where Nike's traditional running shoes are made), but is closer in proximity to the United States.⁴¹ Amazon recently patented a system for robo-cutting fabrics into customised orders, an innovation it could potentially offer as a service to the multitude of apparel companies that operate on its platform.⁴²

These new models could be harbingers of a continuing reduction in the apparel trade and a growing emphasis on localisation. The value chain appears headed toward a high-tech, fast-moving future — and its global footprint could be even more fluid.

The authors work at the McKinsey Global Institute, whose mission is to help leaders in the commercial, public and social sectors develop a deeper understanding of the evolution of the global economy.

Consumer Shifts

The State of Fashion 2019



04. END OF OWNERSHIP

The lifespan of fashion products is being stretched as pre-owned, refurbished, repaired and rental business models continue to evolve. Across many categories consumers have demonstrated an appetite to shift away from traditional ownership to newer ways in which to access product.

In fashion, the shift to new ownership models is driven by growing consumer desire for variety, sustainability and affordability and sources suggest that the resale market, for instance, could be bigger than fast fashion within ten years.⁴³ In recognition of this consumer shift, start-ups will not be the only players making their mark in these segments — established fashion brands will accelerate the pace with which they embrace new ownership models to further their relevance to consumers.

In more and more categories, consumers are choosing to rent rather than own goods outright. Think of Spotify supplanting CD sales and downloads, Netflix replacing video stores and ZipCar standing in for car ownership among many young urbanites. This is a fundamental evolution in consumer behaviour and we expect it will have an impact in the fashion business in the years ahead.

This trend is partly driven by the young generation's hunger for newness, while embracing sustainability. Research shows that the average person today buys 60 percent more items of clothing than they did 15 years ago.⁴⁴ But consumers keep that clothing for only half as long as they used to. For example, a survey done

in Britain found that one in three young women consider clothes “old” after wearing them once or twice.⁴⁵ One in seven consider it a fashion faux-pas to be photographed in an outfit twice. Simply put, young people today crave newness, and these cohorts are much more likely to embrace churn in their wardrobes. At the same time younger generations are more interested in sustainable clothing than older consumers. Rental, resale and refurbishment models lengthen the product lifecycle while offering the newness consumers desire.

Meanwhile, luxury brands are raising prices, significantly. Prices of fine watches and jewellery have nearly doubled since 2005.⁴⁶ Tracking global prices of Louis Vuitton's Speedy 30 handbag suggests an increase of approximately 19 percent per year since 2016.⁴⁷ So, even consumers with six-figure incomes are looking to discounts and alternative models of acquisition for relief.

One in seven consider it a fashion faux-pas to be photographed in an outfit twice. Simply put, young people today crave newness.

Oscar Wong/Getty Images

Consumer Shifts

These demands are catalysing the successes of rental and pre-owned models. We expect that the ability of these players to satisfy a heightened desire for newness and an increased unattainability will bring them into the spotlight in 2019.

Luxury consumers can circumvent the price increases of the Speedy 30 bag, for example, through The RealReal, which was founded in 2011 and, as of May 2018, enjoys a \$450 million valuation.⁴⁸ It sells luxury brands, in gently used form, via a consignment model. The RealReal's hook: top fashion brands, up to 90 percent off. It recently raised \$115 million in a Series G funding round and plans to expand its brick and mortar presence in the US.⁴⁹

“The consumer who is more interested in access versus ownership is happening across many industries. We looked at this evolution and asked, ‘how do we participate?’”

China's YCloset takes a different approach, using a subscription rental model to grant customers access to an array of clothing and accessories free of additional charges. If the customer likes a particular piece, they have the option to buy it outright.

While established brands have traditionally turned a blind or scolding eye towards second-hand retail, they are now wading into the pre-owned and rental markets. For example, Stella McCartney launched a partnership with The RealReal in 2017, offering a \$100 credit to consumers consigning her products on the platform. This can create a circular flow that encourages footfall in Stella McCartney stores, while building confidence in the quality and longevity of Stella McCartney products.

Additionally, because of the circular nature of this partnership, it bolsters the corporate and social responsibility of the fashion brand.

Other luxury players, such as Richemont, have purchased resale or rental businesses outright, to take control of how their products and brands are marketed on the secondary market.

Some players have ventured into refurbishment, taking advantage of its sustainability benefits. Eileen Fisher, through its programme “Renew,” takes back gently-worn products, and either refurbishes them or uses the materials to create new products all together. Patagonia pioneered an in-house repair and resale model by buying back their own products and selling those used items at a discount price. On its website, Patagonia asserts, “The single best thing we can do for the planet is keep our gear in use longer and cut down on consumption.”⁵⁰

Express is betting on the rental market, launching “Express Style Trial,” which allows consumers to rent up to three items at any given time for a monthly fee. In an interview with CNBC, Express' chief customer experience officer, Jim Hilt, states, “The consumer who is more interested in access versus ownership is happening across many industries. We looked at this evolution and asked, ‘how do we participate?’”⁵¹ In New York, French label Ba&sh is offering free rentals over a weekend period as part of its North America expansion strategy.⁵²

Turning to the year ahead, we expect 2019 will be known for three developments in particular. First, the number of brands getting into the rental, resale and refurbishment business will increase markedly; established players will progressively regard alternative ownership as a force they need to embrace or at least test through new collaboration models with retailers or start-ups in the sector. This will require careful business model considerations and a clear choice

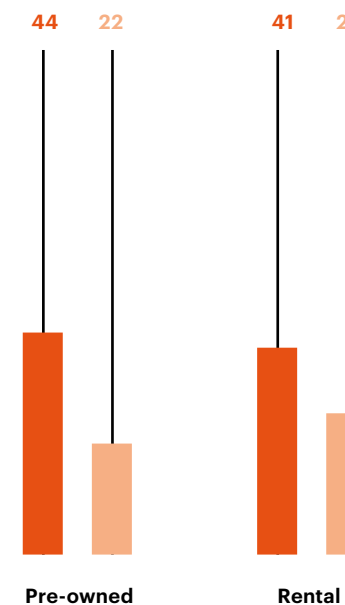
04. End of Ownership

between partnerships, in-house development or M&A. Second, we predict a notable increase in the number of “rental native” brands born exclusively for rental or subscription models. We would also not be surprised to see a unicorn in this space soon. Finally, more consumers will see a growing proportion of their wardrobes made up of pre-owned or rented products, especially for high-value items and accessories. While traditional players need not yet be alarmed, it will be essential to fully understand the emerging signals of what consumers prefer to own versus rent.

Exhibit 8:
Expectations on consumer appetite for new ownership models

% of respondents

More relevant in 2019 Less relevant in 2019



Source: BoF-McKinsey State of Fashion Survey

Jennifer Hyman

Co-Founder and Chief Executive
of Rent the Runway



The chief executive of Rent the Runway reveals the reason why industry leaders keep underestimating the fashion rental market, how she got free real estate and why this market works for consumers who refuse to be ‘ripped off.’

— by Lauren Sherman

BoF: How would you characterise the state of the fashion rental market today?

JH: The fashion rental market globally today is a lot bigger than it’s given credit for [because] if you look at the GMV [gross merchandise value] of the amount of product that is exchanged through platforms like Rent the Runway, and platforms like The RealReal and thredUP, the [latter two are] longer-term lease models versus a shorter-term rental model that is Rent the Runway. I put businesses like The RealReal or thredUP into the larger market of rental businesses because if you buy a handbag right now with the intention of selling it on The RealReal and get a portion of your spend back, what you’ve effectively done is rented that handbag for six months. Rental is about the customer intention behind the usage of the item. When we think about the

merchandise value that passes through — we’re talking tens of billions of dollars’ worth of goods, that’s number one.

\$5 million a year using the same product, with the same inventory. Now, the value that she might be deriving from it is different. One

“I think that there are going to be a few very large, very dominant players in this market. It could be a winner-takes-all market or it could be just two or three businesses emerge as the global winners [but] it’s not an easy business to copy.”

Number two is that there’s a larger movement from consumers all over the world buying clothing for multiple use, to clothing for single-use items. Thirty years ago, 70 plus percent of all fashion purchases in the United States were done at department stores. Now only 28 percent of all fashion purchases are done at department stores. The primary locations of consumption, not only in the US but all over the world, are via channels like Amazon, Walmart, H&M, Target, Zara where you go in and you’re buying cheap clothes where the intention is to only wear those clothes once or twice.

BoF: Who is your customer today and how has that changed over the years?

JH: Our customer base today represents 76 percent of all zip codes in the United States. Given the segregation that exists in the United States, it means we’re catering to almost everyone. We have subscribers who have household incomes of \$60,000 a year, we also have subscribers with household incomes of over

woman is subscribing because she never in a million years would have been able to afford what is being offered via the subscription; [another] woman might be using it because it just saves her time or it’s more efficient for her, or she needs a new outfit for every day at work.

BoF: How has your relationship with designers changed?

JH: The way we work with the industry has changed dramatically over the past ten years. We used to have to beg people to work with us, and now they are coming to us and are really excited about diversifying all the ways that they work with us. Designers were under the impression that they were competing against other designers. If I was Diane von Furstenberg, I might think that I’m competing against Tory Burch or Alice + Olivia. Now designers understand that they’re competing against Amazon and they’re competing against Zara.

With our top 100 brands, we’re their number one or number two

customer. Not only do we work with them on wholesale; we’re working with them on innovation. We’re working on custom collections, on extended sizing, on using data to help inform what they produce in the first place. We help them use rental as a monetisation channel for different components of their inventory, so [in reality], there’s five or six ways that we work with designers to build their businesses. What designers have really seen is that the customer base that Rent the Runway is bringing to them is new and different than their other partners; that we are bringing a new customer who’s trying the brand for the very first time. We’re part of that process of helping that customer fall in love with the brand.

BoF: How did you know that physical retail had to be part of the experience? How have you developed it?

JH: The Neiman Marcus partnership was fundamentally, for us, about free real estate. We would rather have our own physical space that has more square footage where we can control the hours and the experience. When we started our retail strategy many years ago, we didn’t have a subscription business so we had conceived the store in a different way; it would be a place to build awareness of Rent the Runway, give people the ability to try things on before they rented it so that they weren’t fearful about fit. Now that we’ve seen the incredible growth of the subscription business, we’ve seen how a physical footprint can provide even more convenience and magic to the customer base

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that was in that market. We're going to be accelerating our retail footprint throughout the US. We're launching a series of Rent the Runway drop boxes in WeWorks in six different cities across the United States so that our subscribers can walk into the lobby of a WeWork, drop off inventory clothing that they've already worn and immediately new slots will be opened up for them of new items that they can pick from their subscription. It'll make the process of receiving something new from us even quicker.

BoF: How much do you think your consumers care about value and to what extent does it play into their mindset?

JH: We need to switch the word from being value to being smart. The average consumer cares about making smart choices, [about] not being ripped off. She is thinking about how often she's going to use something for. I don't think that fast-fashion is a larger piece of the fashion market. It's just that they've understood earlier that no one is going to spend a few hundred dollars or a few thousand dollars on an item that they're only going to wear once or twice.

There is a lot more intelligence; we know what things cost, we can be in a store, we can look up price comparisons right away. We're shopping on Instagram.

Within this there's an appreciation of quality. I think that the consumer does appreciate that designer clothing and luxury is of much higher quality than what they are buying from Amazon or what they're buying from H&M.

“Now designers understand that they're competing against Amazon and they're competing against Zara.”

Therefore they figure out: 'where and when do I want to invest in quality and when am I comfortable with the low-quality substitutions?'

BoF: There are so many second-hand businesses coming up. Do you think the number of these different services will continue to increase going forward?

JH: Anyone could put up a website and say, 'We're renting Prada.' There's no way to short-circuit this because in order to rent Prada, you have to become an expert in reverse logistics, build all of those direct relationships with the designers to actually procure and buy that product. Some folks have tried to do this via second-hand channels; they just procure the inventory from second-hand or third-hand markets. I think that there are going to be a few very large, very dominant players in this market. It could be a winner-takes-all market or it could be just two or three businesses [that] emerge as the global winners [but] it's not an easy business to copy given how difficult it is to do well and all of the technology and logistical barriers to setting this up and the amount of capital that you need.

BoF: What do you want to accomplish in the next five years?

JH: We believe that this business can be a \$100 billion company. We believe that that is applicable all over the world, it's applicable in all different kinds of categories. As we grow, our designer brands grow along with us. The closer I've got to designers, the more I really want to put bad fashion out of business. I think that it's egregious how they've been copying the intellectual property of all of these designers for many decades and undercutting them. From a sustainability standpoint, there is absolutely no reason to fill up our landfills every single year with all of this junk. One-fifth of LVMH Group is not thrown into a landfill every year; it's one-fifth of H&M.

This interview has been edited and condensed.

05. GETTING WOKE

Younger consumers are seriously concerned with social and environmental causes, which many regard as being the defining issues of our time. They increasingly back their beliefs with their shopping habits, favouring brands that are aligned with their values and avoiding those that don't.

Brands are responding by integrating social and environmental themes into their products and services. The benefits of these policies are clear, but as the causes that some brands champion venture into controversial territory there are risks and consequences for those that fail to get it right.

Nine in ten Generation Z consumers believe companies have a responsibility to address environmental and social issues.⁵³ The inclusion of the latter is a departure from the views of the previous generation of millennials, which had a greener focus. The change is reflected in the higher profile of social issues, and campaigns such as #metoo, #blacklivesmatter and #timesup, all of which have entered the mainstream lexicon over the past couple of years.

The views of Gen Z and millennial consumers are critical. Together, these cohorts represent around \$350 billion of spending power in the US alone (~\$150 billion spent by Gen Z⁵⁴ and ~\$200 billion by millennials)⁵⁵ and Gen Z alone will account for 40 percent of global consumers by 2020. But concern over environmental and social issues is not restricted to younger consumers. Some two-thirds of consumers worldwide say they would switch, avoid or boycott brands based on their stance on controversial issues.⁵⁶ Half of these regard themselves as activists, driven by passion.

The other half are less dogmatic, tailoring their decision to the situation at hand.

Still, the dynamics behind the numbers are compelling. Over the past three years a third of consumers worldwide have expanded the scope of their purchasing decisions to incorporate principled values and views. A new global ethos is emerging, and billions of people are using consumption as a means to express their deeply-held beliefs.

Signs of this evolving agenda can be found beyond consumer sentiment too. Fashion companies are showing signs of getting “woke”⁵⁷ (a phrase defined as “alert to injustice in society,” popularised on social media). For example, based on a “data scrape” of over 2,000 fashion retailers, the appearance of the word “feminist” on homepages and newsletters increased by a factor of more than five from 2016 to 2018.⁵⁸

Many brands and retailers including Nike and Levi Strauss are on board, and both companies have taken a clear stance on social issues in recent months — Nike supporting Colin Kaepernick, the face of the NFL's “anthem protests,” and Levi's fronting a campaign against gun violence. Gucci has also supported that cause, supporting a student-led march calling for more gun control.

And American designer Jeremy Scott appeared at his New York Fashion Week show with a T-shirt urging, “Tell your senator no on Kavanaugh,” in reference to the then-embattled US Supreme Court justice, undergoing confirmation hearings.⁵⁹

Not all causes that fashion brands advocate are universally popular, and these can come with significant risks. Besides potential controversy from supporting divisive causes, brands may also risk being perceived as hypocritical if they do not carefully ensure consistency in their messages and actions.

In Asia, Fast Retailing, the parent company of Japanese retailer, Uniqlo, has made efforts to hire refugees and, since 2016, has donated over \$5 million to the support of refugee initiatives in Asia.⁶⁰ British retailer, ASOS, has taken a different approach to support refugees, launching an exclusive lingerie line in partnership with designer Katharine Hamnett and Help Refugees, an NGO that will receive all profits from the initiative.

Some fashion players have attached collections and ranges to specific causes (H&M launched a Pride collection in 2018 in support of the LGBTQ+ community. Balenciaga collaborated with World Food Programme, donning its slogan, “Saving Lives, Changing Lives”) and others have geared campaigns to reflect beliefs (In a 2018 campaign to promote diversity, Moschino switched to using only models of colour).

Some companies are taking things a step further, putting purpose at the heart of their strategy and operations. There are growing

numbers of B-Corporations, which are certified to have considered the impact of their decisions on people, society and the planet. Companies including Danone, Ben & Jerry’s and Patagonia are B-certified. In the fashion, apparel and beauty sector the number of B-corps had risen to nearly 200 as of April 2018, compared with just seven in 2010. Athleta promises that 40 percent of its products are made of recycled and sustainable materials, while Eileen Fisher and Allbirds have made similar commitments. The latter donates returned used shoes to charity. We would not be surprised if at least one \$500 million-plus fashion company became a B-corp in 2019.

Notably, environmentally- and socially-focused companies are considered by younger cohorts to be better prospects as employers, and the vast majority say they would be more loyal to companies that are aligned with those values. Commitment to tracking organisational key performance indicators is critical, as LVMH has done, setting out to have equal gender representation among executive ranks by 2020.⁶¹ A commitment to values on a group level can have impact on its brands’ culture. As mentioned by Balenciaga chief executive, Cédric Charbit, “I think the fact the brand belongs to Kering, and having Kering expressing commitment towards sustainability and values as a group, makes a difference. You work in an environment where this matters, this exists and we all are committed to this.”

Not all causes that fashion brands advocate are universally popular, and these can come with significant risks. The NFL “anthem protest” was a divisive issue in the US, creating a mixture of applause and backlash for Nike. Still, it created earned media exposure worth more than \$163 million, within just days of the campaign launch.⁶² Besides potential controversy from supporting divisive causes, brands may also risk being perceived as hypocritical if they do not carefully ensure consistency in their messages and

actions. In 2018, Primark was severely criticised and called “unethical” for releasing a line of Pride-themed T-shirts which were produced in Turkey, a country which is ranked third-worst in Europe for LGBTQ+ equality.⁶³ Nike recently faced pressure from civil society groups to ensure fair wages are paid to workers of suppliers in emerging markets.⁶⁴

Another reason that brand alignment with causes can backfire is that discerning consumers can easily spot the difference between gimmicks and a genuine purpose that aligns with the values of the organisation. Companies can expect consumers to closely examine the level of continuity across campaigns and the nature of their strategic and operational decisions, as well as their tone.

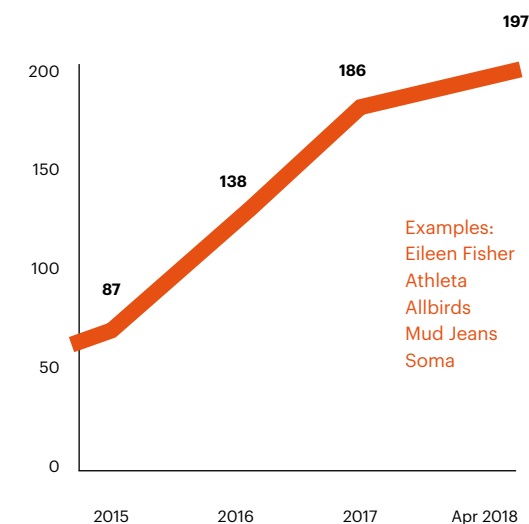
It is worth noting that right now, the movement is much more pronounced in Western markets and that in certain territories it is not at all appropriate for brands to align with certain issues. While consumers in Western markets currently do tend to dominate the movement towards environmental and social conscience, that is likely to change. In the coming year we expect rising numbers of consumers in other markets to increase their levels of commitment. Darshan Mehta, founder and chief executive of Reliance Brands, a subsidiary of the Indian retail conglomerate Reliance Industries, believes “the number of voices is not enough to aggregate to anything significant [yet], but it’s a small wave and a tsunami may wash onto our shores [in India] in the years to come.”

Despite the many associated risks, some large brands will be willing to court controversy to express beliefs, particularly luxury players, which will seek to attract younger consumer groups looking to trade up. There are clear benefits from doing so, and the more that companies express an authentic view, the more that those who don’t will be exposed. And while there is a counterargument that expression of controversial views may deter

some customers, the calculation, of course, is that the loyalty rewarded by its remaining customers matters more.

Exhibit 9:
Total fashion, apparel and beauty B-Corps

Absolute number of corporations



Source: B Lab

Cédric Charbit

Chief Executive of Balenciaga



The chief executive of Balenciaga discusses the culture of self-disruption, Kering's influence on social commitments and the need for brands to focus on members of their community even when they are not paying customers.

— by Imran Amed

BoF: What are the biggest priorities and opportunities for the fashion industry in 2019?

CC: There are two things that I think are going to be game-changers. In the future, we will all make commitment part of the aesthetic. It's what you call activism or being meaningful in what you do in terms of fashion. A product can no longer be only and purely craftsmanship plus creativity and heritage: we need to add values and emotion to it. Products need to be meaningful.

The second thing that I feel is going to be very important is how we engage with our audience. It's of course about the customers and also the non-customers; the people who just want to engage with you on the digital side, for example, on social media and the other stakeholders of the industry. The brand is not only here to sell product to the client. It's also about communicating and conveying messages and values to the entire community of the brand. I think we have to be community-centric, audience-centric. As a brand we rely on many, many other stakeholders. We should really focus on our audience as opposed to just our clients.

BoF: When you're thinking about making a commitment, how do you think about which causes to get behind?

CC: Balenciaga has gained a lot of visibility lately. We have enjoyed much broader exposure than in the past. What should we do about this exposure and how do we raise awareness using the Balenciaga brand as

a platform, not only to convey our creativity and product, grow our business and improve our market share, but also to use the platform to raise awareness? This was very much our mindset in the first place.

It is how we work together with [Balenciaga's artistic director] Demna [Gvasalia]. It's having him at the helm of the creative, artistic direction of the brand but also being part of what we want to do with the brand, its values and its future. Fashion cannot lock itself in the so-called ivory tower anymore. We need to be conscious of the world and reflect what's happening. Demna embodies this new generation of designers who want to express this. I think this is quite important. It started in a very genuine way.

“Fashion cannot lock itself in the so-called ivory tower anymore. We need to be conscious of the world and reflect what's happening. Demna embodies this new generation of designers who want to express this.”

BoF: Why did you make the decision to support the World Food Programme?

CC: It was linked to the creative process of Demna. It's not [just] selecting a cause; it's also making sure it makes sense and it ties back to what he has in mind as a creative vision. The show was about accumulation, it was layering of pieces. It was a sense of opulence and I think he wanted to [contrast] that [with] the World Food Programme, it's to feed that tension between accumulation and giving back.

BoF: What was the reaction from your community?

CC: It was not like we were waiting for feedback; we felt convinced that we should do this and we were extremely determined to do this. There was an authenticity about it. Second, the show exposure and visibility about the World Food Programme is not something that was hidden. It was clear and loud; it was on the runway and it says, Balenciaga supports the World Food Programme. It's a good example of having commitment blended and integrated with the aesthetic as opposed to have commitment being something that we do aside or something we do in the shadows.

I hear store managers and sales assistants telling me that some

customers have [told] them that it's the first time in their life they've made a donation. If we can influence how people dress but also in a way, try also to [make them] think, I think it's great. This initiative has brought us a lot of comments, likes and transactions. At the end of the day, this is how you engage with the community, to engage with the brand, not only via transactions.

BoF: Why do you think brands are taking a more vocal stance now than they might've done before? What

are the dynamics at play that makes this an appropriate thing for a luxury fashion brand like Balenciaga to do?

CC: The fact the brand belongs to [a group like] Kering, expressing commitment towards sustainability and some values as a group I think makes a difference. Nobody's forced [to do anything] but there's an environment and there's a context [that is supportive]. Second, [with] social media and the fact that there's now a direct contact to customers and the Balenciaga community, it's time to not only push product but also to push the values and to explain the creative process in a better way. I would call it storytelling, in a way. What has changed is the fact that there are now leaders in the luxury industry such as Kering that are taking a commitment towards values.

I also feel it's about the direct relationship we have with our community, where we can express ourselves. We're extremely exposed and visible and we could make a difference. It's part of our responsibility. I feel this has always been part of fashion, to push the norm, to change things.

When you think of wearing a logo of a brand, is that an expression of a status symbol? I personally don't think so. I think what matters for our audience is to make sure that when you wear a Balenciaga logo it means you belong to the community, you embrace the aesthetic and you share the values. The creativity of the brand becomes very relevant and important for customers. To put your name on a T-shirt is simply not enough. You need to

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make sure that you engage with people in the right way so they share and they belong.

BoF: Balenciaga, since the arrival of Demna, has been a disruptive force in the industry. How do you keep the core of the brand and what makes it this historical, beautiful heritage brand while disrupting it enough to make it exciting, fresh and new?

CC: The brand is 101 years old and Cristóbal Balenciaga himself was a leader, not a follower. I think we have inherited his spirit. It makes total sense for Balenciaga to be today a brand that is not a follower; a brand that is a leader, pushing the norm, a brand that is doing a very unique casting, a brand that is pushing the norms of fashion, of volumes, of proportions on everything we do. A brand that is trying to rethink how we do retail and our stores, a brand that is rethinking how we act on social media, our tone of voice, who we hire, our community, what we do.

We are called disruptive. Demna is sometimes called disruptive. I feel this is very Balenciaga. It's very much us and when you talk to people internally they all feel we are just simply acting normal and we just do the right things.

Sometimes I'm asked, 'How do you do to get the millennials shopping at Balenciaga?' We simply never ever talk about how to appeal or sell to millennials. We simply never have a discussion on how to break the rules, how to make some noise, how to be disruptive. The brand itself has inherited the spirit of a leader, someone who was

pushing the norm. The models Cristóbal Balenciaga were using were called monsters; people didn't like how they looked. He used some very inexpensive product like fishermen garments and elevated them to a couture level. The guy was a disrupter at the time.

Now that we see the pictures in black and white and we see all this beauty and the power of his creations, 100 years after we feel this is elegance and beauty. At the time it was extreme. It was difficult, it was controversial and not everybody was into it. The reviews were just really tough on him. What I'm trying to say here is Balenciaga the brand has a spirit of being a leader. Instead of disruption I would call it leadership and innovation. Leadership: not because we are at the forefront, but leadership because we do things in a very unique and very Balenciaga way. Innovation: because we look at the brand, the creative side of it, how we engage with people and how we manage the brand in an inventive way as well.

BoF: Your best-selling sneakers have been a big part of Balenciaga's success story. Can you help us understand the luxury sneaker phenomenon better, since you guys were really some of the pioneers who brought this into the mainstream?

CC: Sneakers started at Balenciaga for two reasons. The first one is because it was a creative vision, something Demna wanted to do because he was true to what he felt was right for the brand and with his aesthetic.

Second, the way we have worked sneakers at Balenciaga from a design, a product development standpoint and from a communication standpoint was the same as if it was an amazing couture dress or a perfectly-cut tailored jacket. If we look at the Triple S for example, it's the combination of three different soles that are not stuck together. They're just assembled together. The amount of work to create that shoe for me is at couture level, meaning the shoe is clearly pushing the norms. Balenciaga was pushing the norms whilst creating mega volumes, whilst proposing things that were unique and new and forward. I think there's a lot of DNA in that shoe.

So, why are sneakers replacing handbags? The products we sell today need to be meaningful, let's say I call them smart, like a smartphone for example. The shoe, it's the equivalent of a smartphone. The sneaker itself is extremely meaningful for people. You can work, it's very versatile, it goes from day to night, it goes for the weekend, it goes for work. It's about the casualisation of the place to work and how people dress to go to work. Sneakers have become their own category. It's not a trend; it's a relevant category for brands. I don't want to make a statement. Are shoes the new bags? Maybe. There's a lot of space for bags, but what I can say is that that shoes are also a great alternative to stilettos and sneakers have found a great market share simply because they blend nicely with the way we live.

This interview has been edited and condensed.

06. NOW OR NEVER

The time lag between discovery and purchase is a pain-point for customers who continue to expect better experiences. Companies are increasingly focusing on reducing this source of friction and launching new technologies to enable a smooth and speedy transition from inspiration to acquisition.

The consumer psyche is changing fast. Technology leaders such as Amazon, Uber, Netflix and Deliveroo have raised customer expectations in terms of speed and convenience. Through its Prime offering, Amazon has created an expectation that delivery should be next day, or even same day. Customers now expect to get a taxi, watch a film or receive a meal almost instantaneously, and to make a choice based on an easy-to-assess interface or app.

This resulting need for immediacy shows up in various customer experiences. Some 61 percent of respondents to one UK survey are not willing to wait more than 45 minutes for a takeaway food delivery to arrive. Around one in five say they will wait just 5-10 minutes for a taxi ordered via an app.⁶⁵ This changing sentiment is revealed by shifting patterns of internet searches. Google search interest for businesses and the like that are "open now" has tripled in the past two years. Searches for "store hours" have dropped.⁶⁶ This demonstrates a subtle but fundamental change in mindset.

If tech companies have taken a lead on streamlining the customer decision journey, fashion companies have largely failed to follow. Across the industry, the process is more

fragmented than it is on digital-native platforms, with customers often struggling to shop based on their ideas, desires or inspirations.

One reason is that the way consumers get inspired has changed. In the old world, they would often get ideas for purchases directly from brands (intermediated by magazines) or from in-store assistants. Now consumers turn to a much wider range of inspirations, from social media, celebrities and influencers, to spotting an attractive look on the street. According to a 2017 millennial survey, consumers are more likely to find inspiration from external sources (e.g., influencers, friends, TV) than directly from the brand or retailer (i.e., store website, in-store staff). Some 41 percent of respondents say they rely on influencers and bloggers, compared with just 20 percent who put their faith in store employees.⁶⁷

The increasingly diverse nature of inspiration can be a source of confusion for some, because it removes the direct connection between the idea and the item. Instead, consumers must now seek out the product they are looking for based on their best guess of the right brand, description, season or retailer. This represents a significant pain-point in the customer decision journey.

From a brand perspective, more fragmentation and degrees of separation create roadblocks in converting inspired consumers into purchasers.

The key pain point comes at the stage after the consumer has had an idea, but before they have identified where they can purchase the product. As a result, the instant gratification impulse is frustrated. The consumer moves on and the sales opportunity evaporates. Drilling down into the causes, this pain point is at least partly caused by an inability to identify and find the product. Word-based searches do not lead to the right place and often consumers wouldn't know the right terminology for the product they search. The challenges are particularly onerous when the customer does not know the name of the brand concerned.

This problem is exacerbated by the mobile experience, evidenced by the fact that mobile is capturing share of online traffic, yet conversion rates are still lagging behind other digital channels. Based on a basket of apparel and jewellery retailers in the US, UK, Europe and Asia, average sales conversion rates on desktop are around 3.2 percent, while on mobile they are 0.9 percent.⁶⁸ The cause is that the mobile consumer journey is not yet streamlined or compelling enough to inspire a purchase. It is often that products are difficult to view on a small screen, or that the check-out process is cumbersome and contains too many steps. In any case, the experience is not as seamless as it needs to be. This is a serious challenge for the fashion industry, especially given the relentless migration from desktop to mobile.

In seeking a solution, fashion may learn something from other industries. In music, Shazam enables consumers to identify the name of tracks or albums simply by sampling the music wherever they hear it. The app has 150 million users a month and has been downloaded a billion times.⁶⁹ "There's this huge focus on... doing a much

better job at curation and discovery," says Stitch Fix chief operating officer Mike Smith. "There's going to be a higher burden placed on the retailer and the brand instead of the customer doing all the work."

According to a 2017 millennial survey, consumers are more likely to find inspiration from external sources (e.g., influencers, friends, TV) than directly from the brand or retailer.

In fashion, some emerging technologies are similarly aiding in product identification. 21 Buttons is a social network that is designed to increase "shoppability" potential, by enabling influencers to share shopping links to items they wear in posts.⁷⁰ WeChat users are linked from blog posts directly to brand mini e-commerce sites, allowing them to find inspiration and purchase in one place without ever leaving the Chinese "mega-app."

Looking forward, visual search is a particularly interesting proposition for the fashion industry. Screenshop enables users to take a screenshot or picture of "tops, skirts, shoes, etc." and then shop similar items straight from their phones.⁷¹ UK start-up SnapTech (previously SnapFashion) is a leader in the field. Marie Claire editors used the company's Snap the Celeb feature to search for high street options that were similar to what they were seeing on the catwalk or street.⁷² Elsewhere, Israeli company Syte.ai has developed a visual tool for fashion (serving some of the big high street fashion names as clients) and raised \$8 million in early funding.⁷³ Singapore-based start-up Visenze AI launched "Shoppable User Generated Content," a visual recognition tool that "understands and tags user-generated contents making items within images easy to discover,

search and purchase,"⁷⁴ and works with leading retailers, such as Myntra.⁷⁵

Larger fashion players and retailers are also catching the wave, either developing tools in-house or partnering with technology companies. Asos, for example, has developed a "Style Match" search tool and the company expects visual search to help drive sales growth of 30-35 percent.⁷⁶ Chief executive Nick Beighton remarks, "One of the things we are solving for customers is, 'What do I wear this morning? What do I wear to do whatever I want to do today, to feel confident about whatever I'm doing?' Visual search is one of the ways to take away that friction."

Forever 21 partnered with Donde Search to create Discover Your Style, a visual search tool which can locate items from features such as silhouette and colour. A pilot increased average purchase value by 20 percent. Finally, eBay has launched an app allowing users to find items based on photos. The company says AI is driving more than \$1 billion per quarter in incremental sales. Amazon is using artificial intelligence to help people shop. Its "Echo Look" functionality is able to learn about an individual's style and make recommendations based on what it sees.

It is interesting to note that, while many players are racing to innovate in this space, it appears that no single player has captured mass customer adoption — yet. We think 2019 is the year we will see clear signals of how these tools will integrate into the day-to-day shopping experience for the average fashion consumer, and which ones will succeed.

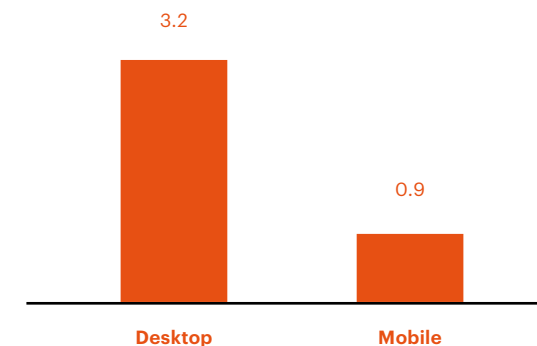
The implications of these new technologies are considerable and will lead to both defensive and offensive plays. On the defensive side, we expect next year the majority of fashion players will integrate commerce functionality into social media, enabling direct-to-product journeys. They will also likely continue to invest

in improving mobile conversion rates, streamlining the check-out process, improving search and optimising the user experience. Offensively, we expect brands and retailers to increasingly collaborate with technology companies to develop proprietary tools such as visual search engines. We predict that once one solution becomes a clear winner (such as Shazam in music), there will be a step-change increase in consumer adoption.

Exhibit 10:

As conversion rates are significantly lower for mobile than desktop, retailers will work to improve the customer journey

Fashion average sales conversion rates, desktop and mobile, %



Source: McKinsey & Company

Jeff Gennette

Chairman & Chief Executive of Macy's



The chief executive of Macy's talks about off-price competitors, the magic of radiated sales and how he plans to reinvent the store experience across America by removing pain-points and friction.

— by Imran Amed

BoF: As you look to the fashion industry in 2019 what are the biggest challenges and opportunities for fashion and retail today?

JG: Consumers are their own curator now. They're armed with more information that is informing a more competent point of view about how they put themselves together and how they use fashion for individual expression. That's flipping what the role of a retailer is today and recognising that you've got this customer that is, in some cases, ahead of you. But you also do have a lot of customers that are looking for you to help them curate, and then allow them, through personalisation engines, as broad a menu as possible online so they can curate for themselves.

We're also finding that our customers are spending less on apparel and expecting more experience. We now have new economic models that can help us add experiences into our brand that we didn't have at

our disposal before. A store needs to be broader than just a place of transaction. It needs to be a place where people gather and if you don't bring in experience, education and entertainment, you're not going to do as well. When you create community within a store and you bring customers together they stay, they linger — and they buy things but they come together in another way.

“A store needs to be broader than just a place of transaction. It needs to be a place where people gather and if you don't bring in experience and education and entertainment, you're not going to do as well.”

We're also looking at VR, and how it bolts onto a strategy and drives customer advocacy. We played with VR to say, 'Okay, let's put it into our furniture business.' We had this issue with furniture, which is one of our signature businesses, where we could only sell the whole assortment in no less than about 20,000 square feet. Now with VR we can do it in 5,000 square feet. It's opened up our ability to get furniture into a lot more of our buildings. It's massively increasing the basket size of that purchase [and] it's massively reducing the return rate. Using technology to solve a stubborn problem and solve where a customer is needful of more inspiration is how we're looking at technology. I think this confluence of experience and technology with any retailer today would be the second biggest thing that I would comment on.

Then, the last thing is going from a 'house of brands' to a 'branded house'. Customers aren't buying monolithically by brand any more. As a retailer, you'd better have your own ethos about what you stand for — that's your particular competitive mode. It better be something that a customer gives you credibility for and that you can credibly do, and you can do it with the least friction possible. This idea

that what you stand for [is more important than] the sum of all the parts of what you used to carry in your brand.

BoF: What has changed in the way you think about the function and purpose of a retail store? If everyone can buy everything online, what is it that really gets someone into a store now?

JG: This took us a long time to figure out. We had too many stores through many acquisitions over the years, [so] when you look at a store of our size, we were almost virtually all mall-based. We had to look at our portfolio and shed those units that didn't make sense to the [local] community, either because the mall developer wasn't investing, or the mall was extraneous because we had a more powerful location nearby.

We spent a lot of time over the last five years shedding a lot of those extraneous stores. We ended up with a remaining portfolio that is balanced well across all the major markets in the country. We look at those flagships and aspire for those to be just these heart-pounding, all-five-senses tourist attractions, like what we're doing in Herald Square. That's our vision for what a flagship could be.

Then the next category of stores is our regional flagships and there's about 250 of them in the States that will stand the test of time. They're the A malls that are evaluated by Green Street. All of our mall developers are investing heavily. What they're doing in those malls is they're actually taking a lot of apparel and accessories out of those malls and re-mixing their tenant mix. They're putting in a lot more food and beverage and they're putting in more entertainment. They're putting in mixed use [and] community centres.

Then the third bucket is tertiary malls. The mall developers are not investing in them; they're milking them for cash. But they're neighbourhood stores for us and so we've got customers that want to pick up their basics. They really want to use their fulfilment options; they want to buy something online; they want to have it shipped to the store. We can operate them much more efficiently to make them better experiences.

We have new economic models like what you're used to in Selfridges, where 50 percent of what is in that building is leased. It's about 5 percent in the States,

so I can start playing with that line, the economic model, to say, “Look, I’ve got space. You’ve got a brand and I’ve got traffic. I’ve got a devoted customer that, frankly, [if] I put your brand in there and I give you space for it and start leasing more of that for something that’s added into the customer experience.” We’re looking at services...like travel, watch repair, post offices, pharmacy [and] what we’re doing with optical.

BoF: In a way, that’s more of a real-estate model, right? It’s almost like a mall within a mall, is that correct?

JG: Yes. For instance at Selfridges: when you go into that store, you don’t know what’s leased and you don’t know what’s owned. It’s absolutely seamless to the customer. I think it’s got to be; what are the needs of the customer and how do you make it as easy for them as possible? When they walk in and it’s Macy’s, it’s got to be a Macy’s experience. A concession model traditionally has all been about that brand or that subset and it hasn’t been customer centric. I think the hybrid is that whatever’s in that building has got to be [consumer focused so] that the customer is able to navigate any way that *they* choose.

BoF: One of the things you mentioned was that neighbourhood stores can be run more efficiently; what did you mean by that?

JG: Today we have a lot of businesses that are really transactional and we treat them like there is a service component to

them. There’s six businesses in the entire store that need really [hand-to-hand] attention at all times. Those businesses are businesses where Macy’s remains relevant, so we’re in the game with market share [for big ticket segments] like furniture, mattresses, as well as men’s clothing, dresses, fine jewellery, women’s shoes and the entire beauty floor.

When you start looking at [other] businesses like most casual sportswear, kids, handbags, if you have the brands and you have the right values, you can do it without human capital. That’s where you can be much more efficient. If you look at what’s going on in off-price right now you see that it is operating with very reduced selling cost. But what they have is they have a thrill of the hunt. They have a much faster turnover. They’ve got new content that’s arriving daily. They’ve got great prices that are incredibly transparent to the customer. It’s very easy, there’s no sales, no gimmicks.

You start to think about those businesses, particularly in a lot of the apparel businesses, and if you get that model right you can do it with less human capital cost, which would mean that you start to eliminate registers, you start to reduce space in these stores and really curate the assortment so that you just bring into that local store that content which is right for that community.

BoF: How does that connect with the online component?

JG: Hand in glove. It’s totally supportive and symbiotic, especially when you think about

‘buy online, pick up in store’, [considering what] we carry right now — about ten items online to one item in a store in terms of the SKUs. We believe, in terms of ‘endless aisle,’ that we can take that SKU assortment higher. In the past, you had to have that one item that you were ordering online in that store in order for a customer to pick it up and so we were constrained by whatever the customer was ordering online. [So] we added a thing called ‘buy online, ship to store’.

The customer is loving the fulfilment options that most retailers, who are omni-channel, are [moving towards]. You have lots of options once it hits that store. You could have it delivered to the customer’s office if they choose. In most cases, they come and pick it up and they hang out in the store. In about 20 percent of those cases, that customer buys something else when they’re in the building. Generally what they’re buying is equal or higher than the value of what they’re picking up, something we call radiated sales.

BoF: If there are fewer check-out areas and less human capital, does that mean the future of retail potentially has robots and automation in terms of serving customer?

JG: I wouldn’t say it’s robots, but what I would say is that every customer that comes into our stores has got their mobile device. If we can make that as purposeful and as useful to them as we know it can be, there’s so much that opens up to them that gives them control of that transaction and that experience.

The power of the mobile device is [that] everything the customer needs is going to be in that device. However she wants to transact, what payment types she wants to pick, what coupons she wants to select, if she wants self-check-out, everything is in that portion of the mobile app. This idea about the store opens up and you can do whatever. It will tell you product reviews, it will give you online video. It just exposes you to whatever you want to know about that building or the products within it or the services that we offer within it.

Then the third idea about the mobile app is what we call My Stylist, which is your opportunity to get help on demand. When we offered our beauty customer the opportunity to self-select, we saw how many of our customers did not want to deal with the sales colleague. They want to know that you’ve got their size, their colour. Once they find that, they don’t necessarily want to deal with a colleague.

BoF: As you gather more data from your customers about their purchasing behaviour, the way they operate in store, the way that links to their online behaviour, what can you imagine a company like Macy’s could do with that data?

JG: The biggest opportunity is what we can offer the customer in terms of a recommendation engine that satisfies every one of her needs. If she’s got a tendency or proclivity to buy a particular brand, but only on sale, it notifies her when we’re taking

markdowns on that brand and we’re going to save a size 8, if that’s her size. We’re going to have her style that’s ready to go whenever she wants to buy it.

She’s got to agree that this is something that she wants. The customer is going to be in charge on this. We’re going to be able to have data to operate as a tool for her, but our biggest mission is; how do we make it easier for a customer? There’s still way too much friction with all retailers. You’ve got Amazon that’s done a great job with convenience and price, but no brick-and-mortar interface with that. I think Macy’s does a good job on those subjects. We have brick-and-mortar interface, which gives us our competitive mode.

This interview has been edited and condensed.

Digital Innovation Made Simple

A guide to the tools that can help you enhance customer experience quickly and flexibly.

by Tunde Olanrewaju and Neil Robbins

When it comes to the use of technology in fashion retailing, there are two truths universally acknowledged. First, that technology is very important. Second, that it is very difficult – time-consuming, expensive and risky.

The first is true. The second is not.

Already, fashion is seeing a constant stream of innovation, with technology creating new experiences for customers. Asos, for example, is using visual search to let customers purchase items that they've seen, even if they don't know the brand or the name of the item. Asos customers can also talk not to a sales assistant, but to Google Assistant. Zara is shipping products to customers straight from their stores. Zozo is producing custom-fit garments on a mass scale. Innovations of this sort often begin as a novelty in the market but can quickly set new customer expectations. Once customers experience Amazon Prime delivery, for example, or shop using apps on mobile devices, it becomes harder and harder to lure them back into stores or to force them to use old-fashioned websites and wait a week for delivery. While experiences such as these would have seemed daunting to create only a few years ago, with developments both in technology and in the way in which technology is delivered, it need not be daunting anymore.

Two related factors enable companies to deliver experiences such as these. The first is growth in simple services, platforms, and components which can be used to deliver sophisticated new capabilities. The second is the ongoing upgrade of legacy IT systems, and the range of technologies that can support modernising the core of a business.

The growth in public cloud space has led to an increase in the availability of both software-as-a-service (SaaS) and platform-as-a-service. Using public cloud platforms, highly scalable,

secure application-hosting infrastructure can be set up in a matter of hours. In addition to the big public cloud players themselves, companies such as Twilio, Stripe, HooYu, ProductAI, Wooti and Shipright (among many others) have built services that can be integrated into new experiences using APIs [application programme interfaces]. APIs allow services to be used in ways that are suited to machines, rather than people. The cost of using APIs has reduced significantly, making it much simpler for companies to “plug in” capabilities and swap them out for a different service when desired. APIs are also becoming easier to use. Historically, API design emphasised dependability and security; however, as they have grown in popularity, designers have begun to make pragmatic trade-offs between technical concerns and ease-of-adoption to appeal to developers. Finally, open-source libraries, freely shared by companies such as Netflix, Google, Airbnb, Microsoft, Facebook and others, have now become mainstream, leading to a dramatic reduction in the time it takes to develop custom applications.

Most companies will build new capabilities using existing systems, many of which may not have extensive, high quality APIs, or be built to support the volume of traffic arising from public use (as compared to internal use). To create new customer experiences and modernise their IT systems, a company in this situation will need to implement APIs where they are missing and look to pragmatically modernise at least some of their systems to support higher levels of use. Unlike when Amazon.com set out on its journey to modernise its systems back in 2001, there are now established approaches, technologies and tools that can support this.

But, what does all of this mean for a business? If you're like most businesses in the fashion industry your e-commerce sites have a traditional interface and you are struggling to evolve your business in

line with technology advances. True omni-channel capabilities are likely absent, customer experiences are mostly not personalised, and if there are digital recommendations then these will tend to produce poor results. Behind the channels, there is often a lack of real-time information on the performance of the business, for example not having real-time awareness of local stock levels. Producing experiences of the kind that Asos or Zara are offering would mean a major software delivery project, requiring significant time and resources to bring it to market.

Using the approaches outlined here, combining best-of-breed technology with lean product development approaches, similar experiences can be brought to market in just a few weeks. So, what should a business do to make this happen? Firstly, it needs to approach this not as delivering individual projects, but as building a real capability that can deliver and own digital experiences. This means putting together cross-functional teams and empowering them. Realistically, a cross-functional scrum team should be able to create a market-ready solution using technologies such as these in just a few weeks, and then continuously improve it multiple times a day. A typical team would consist of approximately ten people, including roles such as a product owner, user experience (UX) and user interface (UI) designers, web developers, mobile developers, systems engineers and data scientists. The team should be co-located, empowered to make rapid decisions, and funded as a mini-business with their own P&L so that they can set direction by the business metrics that matter. Importantly, an enduring capability should be built to do this within the business, rather than outsourcing it as a one-off project.

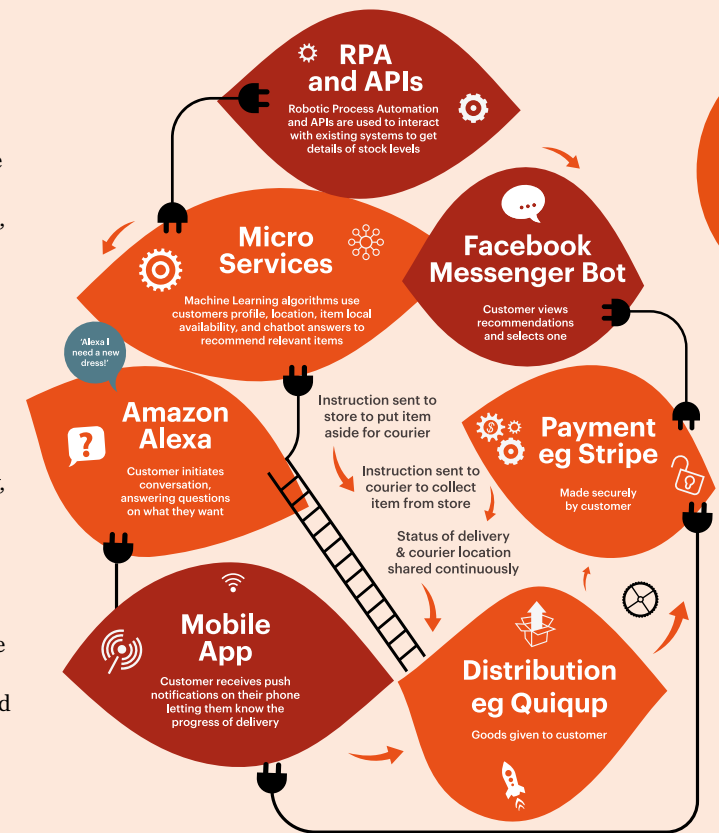
The technical building blocks already exist; a company does not need to build the integrated solution from scratch. These existing capabilities can be rapidly stitched together using SaaS capabilities. Some custom building will still be required, but this can focus on those distinctive aspects that make the end service novel and focused. Tackling the legacy of existing systems will require top-notch architectural

skills that can take a pragmatic, progressive approach that continuously transforms the technology of the business.

Customers' expectations are always rising, and sometimes companies struggle to keep up. But by taking the time to invest in new technology and capabilities, companies can rapidly create valuable new customer experiences, manage them cost-effectively and continue evolving them to keep pace with a rapidly changing world.

The authors are part of Digital McKinsey, which brings together all of McKinsey's technology and digital capabilities in one cohesive organisation.

An example of how existing software and platform services can be integrated to transform the customer experience:



Source: Digital McKinsey

07. RADICAL TRANSPARENCY

Fashion companies must come to terms with the fact that a more distrusting consumer expects full transparency across the value chain. Given the need to regain that trust, fashion players cannot afford not to examine long-standing practices across their businesses.

The fashion industry suffers from a rising trust deficit. Recent high-profile data breaches at a number of online fashion companies, and in other industries, have left consumers wondering whether they should share information with brands and retailers. As a result, they are demanding to know much more about a range of issues, from where and how items are made to the design provenance and the item's quality.

As Mike Smith, chief operating officer of Stitch Fix, asserts, "If you don't have trust, you don't win the customer over time." Yet surveys suggest that trust in businesses fell in 40 percent of countries in 2017, with more than two in five consumers saying they didn't know which brands to trust. It makes sense that as trust has eroded, consumers have become more active in scrutinising the brands they do business with.

Millennials are at the vanguard, with 52 percent agreeing that they always research for background information before buying, compared with 45 percent of Gen Z consumers and 41 percent of baby boomers. Reviews and articles are common sources of information.⁷⁷ "Social media has enabled a certain transparency," says Farfetch chief strategy officer Stephanie Phair. "You can no longer control your luxury messaging within

borders." We expect the critical dimensions in which fashion players will be most scrutinised include: creative integrity, sustainable supply chains, value for money, treatment of workers, data protection and authenticity.

From a creative standpoint, brands need to show they bring something to the table that is based on their own intellectual property. Copycats are increasingly called out on social media. For example, @DietPrada, an Instagram account that boldly names brands that have lifted styles from other designers, has over 830,000 followers at the time of printing. Cases of cultural appropriation — described by The Economist as instances where a "dominant culture" wearing or using things from a "minority culture" is inherently disrespectful because the objects are taken out of their native context⁷⁸ — have gained instant notoriety on social media. Consumers are increasingly demanding that the products produced by fashion brands are original, reflecting their own desire for their fashion choices to be reflections of their sense of style, self-image and values.

Transparency has become an important issue further upstream in the supply chain, with consumers increasingly concerned about issues including fair labour, sustainable resourcing and

the environment. Consumers want to support brands that are doing good in the world, with 66 percent willing to pay more for sustainable goods. Some 42 percent of millennials say they want to know what goes into products and how they are made before they buy, compared with 37 percent of Gen Z.⁷⁹

Brands are responding by trying to become more transparent, in many cases specifying costs of materials, labour, transport, duties and mark-up.

In response, several brands have already moved towards "radical transparency" in manufacturing, hoping to regain the trust of disillusioned customers. This might include information about product origins or the environmental impact of manufacturing. One mass market player example is H&M-owned Arket, which lists where each product is made, showing pictures from the manufacturing floor.⁸⁰ Designer Martine Jarlgaard, meanwhile, has launched a pilot to track clothing from raw material to consumer using blockchain.⁸¹ The retailer Reformation applies its "RefScale" methodology to measure the environmental impact of every garment it sells, and discloses the results to customers. RefScale tracks pounds of carbon dioxide and gallons of water used in production.⁸² Other supply chain tracking technologies include analysing dust samples and using AI to trace the geographic history of a product.

Another increasing concern among consumers is value for money. This reflects increased product saturation, proliferation of product information and reviews and the rising ability to compare prices. Brands are responding by trying to become more transparent, in many cases specifying costs of materials, labour, transport, duties and mark-up. San-Francisco

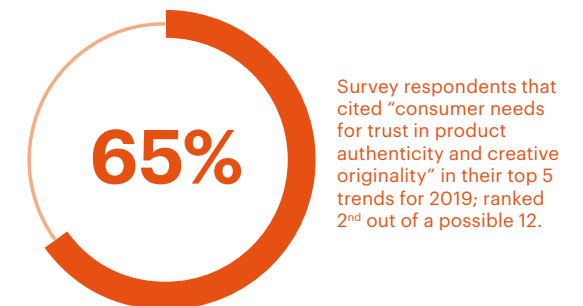
07. Radical Transparency

apparel company Everlane offers its customers insight into all these costs, alongside information on the factory that produced the products.⁸³

Given consumer demands for greater transparency through the value chain, we see three key dynamics in the coming period. First, players will rigorously audit their business practices to identify potential areas that may erode consumer trust. The lens for this analysis could be, "What would my customers think if this was on the front page of a newspaper?" Brands will invest to address any problem areas. As a result, more players will highlight their best practices to create a competitive edge. Some will use new technologies such as blockchain, in which each node of the network sees the whole history of transactions, to boost transparency in the supply chain. We also expect more rigorous reporting of social and environmental impact. Finally, brands are likely to be more transparent in the event of a crisis. They will respond more quickly, admit when they are at fault more often and be willing to apologise.

Exhibit 11:

Fashion executives anticipate consumers' need for transparency



Source: BoF-McKinsey State of Fashion Survey

Dealing With the Trust Deficit

Unless fashion brands adopt best practices from outside the industry and improve supply chain transparency from within, consumers will begin to wonder what they have to hide.

by *Kati Chitrakorn*

They say it takes years to earn trust but only an instant to lose it. With trust in very short supply among today's consumers, some companies are going to extraordinary lengths to claw it back. As one of the most traditionally opaque industries out there, fashion faces an especially challenging future in this regard, but instead of grappling to invent new ways to beat the trust deficit, it could look to other industries for inspiration and best practice.

The kind of radical transparency that some fashion players will embrace tomorrow is being played out in the supermarkets today. Arguably, nowhere is traceability more important than in the food industry and since Europe's horsemeat scandal of 2013 — which exposed a sector where some products advertised as 100 percent beef contained undeclared meat from other animals including pig and horse — more and more consumers are asking whether we really know what we're putting on our plates.

The more complex that global supply chains become, the more vulnerable they are to fraud and error. Sensing that customers were still very distrustful of the supermarket giants, Marks & Spencer (M&S) recently introduced complete traceability of all its beef products. One motivation for M&S would have been to implement a system to prevent it from meeting the fate of one of its rivals, Tesco, which in the dark days after the horsemeat scandal saw hundreds of millions of dollars wiped off its value.

Initially M&S' upgrade was met with scepticism but, as it turns out, the firm's high-tech investment is gradually improving consumer trust. It took years of R&D and operational restructuring, but

today the retailer can trace the origins of a single beef patty with such detail that it can name the breed, age and even the name of each individual cow. Individual identities using a series of letters and digits based on a DNA profile taken at the abattoir that can, in turn, be traced back to the farm of origin.

By partnering with Dublin-based tech firm Indentigen, M&S uses a genetic sampling technique that analyses the molecular signature found in the smoke emitted when a tiny sample of the meat comes into contact with a laser. The move has been viewed by some as a benchmark when it comes to radical transparency, as consumers increasingly demand to know the provenance of their food.

“An apparel company might think that they only have 1,000 to 2,000 suppliers, but the reality is they have 20,000 to 50,000 when you count all the sub-suppliers.”

But beyond groceries, the question of precisely where our goods come from remains as pertinent as ever — and one that the fashion industry has not yet been able to solve at scale.

“[What] only a few leading brands are doing is [offering] full traceability [of their supply chain]. That means that in theory, you can scan a barcode on a shirt and know the actual supply chain for that particular garment,” says Leonardo Bonanni, founder and chief executive of Sourcemap, which helps brands trace the journey of their products.

Radical transparency is coming soon across the supply chain. Unless fashion brands adopt best practices from outside the industry and improve measures from within, consumers will begin to wonder what they have to hide.



“It’s been well established in food, pharmaceuticals and other industries for years. We need to get there with apparel.”

Long Legacy of Bad Habits

In the not too distant fashion past, a lack of transparency in a company’s supply chain could actually be seen as a competitive advantage. Businesses wanted to keep insight into their suppliers and manufacturers as opaque as possible. After all, if nobody knew where the products were coming from, or how they were being made, it was harder for competitors to create identical apparel.

“The idea of mystique is one that is so engrained into the fashion culture of total exclusivity [that] brands hid what they’re doing from everybody,” says Tamsin Blanchard, a veteran journalist focused on sustainability and ecological issues in fashion.

“Apparel is one of the most volatile and fast-changing supply chains that I know of.”

For Neliana Fuenmayor, founder and chief executive of A Transparent Company, which advises brands on sustainable innovation, the luxury end of fashion is especially problematic, “[Consumers] don’t question luxury because if it has that high price ticket [then] you want to think it’s been done in the best way possible.”

However, news in summer 2018 that Burberry had burned \$37.6 million worth of unsold clothes and accessories, instead of selling it off cheaply, to protect its brand, shocked consumers. It’s a practice notably not exclusive to the British fashion brand but the secretive nature of the industry makes it difficult to accurately quantify the scale of the problem.

The public outrage and negative media attention prompted Burberry chief executive Marco

Gobbetti to address the issue with a plan that would see a complete turnaround. “We are now in a position to [stop] destroying finished products, which we think, frankly, is just not modern,” he told BoF in September.

It is clear there has been a shift in the way consumers view transparency. In today’s world of post-truth politics and “fake news,” consumers’ distrust of governments and media has extended to every aspect of their lives, from food to medicine and fashion. Surveys suggest that trust in businesses fell in 40 percent of countries in 2017, with more than two in five consumers saying they didn’t know which brands to trust.

The fashion industry, in particular, has been suffering from a rising trust deficit. After more than 1,100 people died in a garment factory collapse in Bangladesh five years ago, pressure has mounted on Western retailers to be transparent about their supply chain. Other horror stories of garment sweatshops, abuses, child labour and deadly industrial disasters have put brands under scrutiny by shoppers who are increasingly demanding to know if their products were made ethically and sustainably.

Yet transparency remains a major challenge for the global fashion industry, one that was worth \$2.5 trillion in 2017, according to the McKinsey FashionScope, which relies on very fragmented supply chains often spread across multiple countries.

Following the Rana Plaza disaster in Bangladesh, it took weeks for retailers to figure out why their labels had been found among the ruins in the first place and which purchasing deals had been made with those suppliers. As a great number of retailers do not own their own manufacturing facilities or use a system of agents and subcontractors known as “indirect sourcing,” it makes it difficult for companies to monitor conditions across their supply chain.



Frédéric Soltan /Corbis via Getty Images

“An apparel company might think that they only have 1,000 to 2,000 suppliers, but the reality is they have 20,000 to 50,000 when you count all the sub-suppliers. It’s a real challenge [for brands] to map their supply chain because there are too many third parties involved,” says Bonanni.

What often happens is that a factory may take an order, only to find that it doesn’t have the capacity to do all the work and, without notifying the brand, the factory owner may then delegate the work out to other factories, which could be unregistered and therefore the kind of place where labour and safety violations occur. “Many larger fashion brands don’t have visibility on suppliers more than one degree removed,” says Jessi Baker, chief executive of Provenance, which helps brands track their supply chain using blockchain.

The speed in which fashion operates also poses a challenge. “The apparel industry is in an unusual conundrum, because it has the highest turnover in supply chain of any industry,” adds Bonanni.

“Some brands are doing fast fashion, others are doing four collections a year, but there is a continuous turnover. With food, you don’t change that often. Apparel is one of the most volatile and fast-changing supply chains that I know of.”

Trade Secrets and Tokenistic Gestures

M&S was one of the first mass-market companies to take tighter control of its supply chain by putting a factory map up on its website, sharing what happens where in the world for many of its categories, including clothing, homeware and food. According to the Global Fashion Agenda (GFA), 12.5 percent of the global fashion market, including big names like Nike, Adidas, Levi’s and Gap, have signed up to 2020 sustainability targets, which include publishing lists of all the suppliers producing for them.

H&M says it mandates that all suppliers sign a sustainability commitment. In 2017, the company also launched a moderately higher-priced brand called Arket, which focuses more on staple pieces than trends. Each item of clothing purchased online or in-store comes with information on the location and name of the factory where it was made. “When we communicate that, customers have the option to make more sustainable choices,” says Karin Brinck, sustainability manager at Arket. “We see transparency as one of the means for our industry to drive positive change through increased openness.”

Meanwhile, retailers like Maiyet have approached transparency by stocking only what it considers socially conscious “positive impact” brands in its recently opened London concept store. According to co-founder Paul van Zyl, the aim is to “promote transparency by sharing the provenance of each brand and creating an environment [for] founders, designers and certifying bodies to come together in an open and honest way.”

While this degree of transparency in the fashion industry is a positive change, it still raises some



The State of Fashion 2019

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“There has to be a corporate culture shift within the company so that sustainability and transparency can be achieved across all departments. The problem is that companies are split into departments and that causes fragmentation and silos. We need to move from a centralised system to a more decentralised one.”

important questions: what is a shopper supposed to do with that information?

“I think it’s a bit tokenistic,” says Rachael Stott, senior creative researcher at The Future Laboratory. “If you’re given the name of a factory or the provenance of a garment, it’s too vague to really help [the consumer] at that point of purchase. I still have to go away and research these factories and names. There’s no guarantee for me as a consumer that what I’m buying is ethical.”

“We see transparency as one of the means for our industry to drive positive change through increased openness.”

There’s also the debate of how much a factory has to be in compliance. Several experts agree that no company is perfect, so should consumers hesitate to buy a T-shirt or pair of jeans if 80 percent of a factory is up to standards? Is anything less than 100 percent acceptable? Sourcemap’s Bonanni points out that there are currently no uniform standard on what constitutes as an ethical or sustainable factory. “There are different levels of transparency but we need a standard in the industry, so that the consumer understands,” agrees Fuenmayor.

Another challenge with rising levels of transparency is it can lead to the over-sharing of company affairs and potential conflicts with the need to protect trade secrets, information and privacy. In the workplace, for example, business owners have a responsibility to their employees to disclose problems that might lead to employee dismissals, but discussing every loss, financial struggle or employee salary could lead to unrest, loss of confidence and detrimental competition among employees. The same applies to fashion.

“Fashion companies are very careful with how they share information [and] that’s one of the blockers

for why radical transparency is challenging,” Fuenmayor continues. “If you’re a brand choosing which supplier to make a product, you’re trying to push down the price as much as possible. That’s where the secretive part comes in because suppliers might offer certain brands a better price than their competitors and so it becomes a grey area.”

Using Technology to Improve Disclosure

But as impossible as full transparency may seem, it’s clear that the pendulum has swung too far in the other direction for far too long. “In the future, not being transparent raises a red flag. Consumers will question... what are you hiding?” Fuenmayor continues. “What is luxury today? Is it a logo or is it a product that I know has not cost someone’s life or the environment? We have to understand that we have more power as consumers, because we’re paying with our wallets every day when we choose a brand or service.”

“Increasingly there are vegan customers who want to know what materials are in [their clothes, for instance] and not just what they’re eating,” says Blanchard. She argues, however, that transparency is especially important for fashion because, “food, you eat it, then it’s gone, whereas with fashion, you wear it and it’s still going to be there. It’s either going to be in your wardrobe or in a landfill.”

Radical transparency doesn’t only apply to production; it can be applied to pricing too. One of the early pioneers of this was Bruno Pieters, who started his own label Honest By in 2012 after stepping down from a leading role at Hugo Boss. So meticulous was the Belgian maverick that shoppers could not only trace the manufacturer and composition of the garment, fabrics and lining but also that of the zippers, buttons, thread and even the safety pin holding the hang tag to the item’s care label.

Whenever he could persuade textile suppliers to reveal details about origins and sources, Pieters

created a painstaking “pedigree” that traced the fabric through the supply chain of raw materials, yarn spinners, weavers, printers and dyers. More surprising was — disclosed on the product detail pages of the brand website — an itemised break-down of the garment’s cost to the very last penny, including his wholesale and retail mark-up percentages. When news broke in October 2018 suggesting that Honest By might be closing down, some saw it as a sign of how hard it is to sustain a business in fashion without compromising on transparency.

Transparency is also important in terms of disclosing how companies operate. Fitness technology firm Fitbit, for example, has access to extremely valuable customer data, which may leave people feeling uneasy. It hopes to quell these concerns by being completely open about which data points they collect and how they share it. Meanwhile, charity services like BitGive and AidCoin use technology to provide greater transparency to donors by sharing real-time financial and project information.

What’s clear is that while technology has played a part in generating much of today’s mistrust, it can also be leveraged to restore trust and confidence.

Blockchain, for one, has the potential to fix this. The underlying technology driving cryptocurrencies such as Bitcoin, blockchain is a decentralised and distributed digital system of records that cannot be altered once they have been added. The global blockchain technology market was estimated by Statista to be worth \$339.5 million in 2017, and is forecast to grow to \$2.3 billion by 2021.

This technology is already being slowly implemented in a number of industries. Swiss tech firm Ambrosus offers blockchain for the food industry, making it accessible to both emerging start-ups and billion-dollar brands. The firm uses high-tech sensors and blockchain technology to record the entire history of food and pharmaceutical products. By using a smartphone, anyone in

the food chain — producers, suppliers, retailers or consumers — can access so-called “tamper-proof” data about their product at any stage in its supply chain life cycle.

The fashion industry, however, seems more reticent. Martine Jarlgaard’s pilot programme to track clothing from raw material to consumer using blockchain is a start. However, it will take much bigger developments from blockchain specialists like VeChain, whose chief executive Sunny Lu is the former chief information officer of Louis Vuitton China, to move the needle.

Meanwhile, De Beers, the world’s biggest diamond producer by the value of its gems, said it planned to launch the first industry-wide blockchain this year, to track gems each time they change hands from the moment they are dug up from the ground. The technology could be used to verify the authenticity of diamonds and ensure they are not from conflict zones where gems could be used to finance violence.

“Fashion companies are very careful with how they share information [and] that’s one of the blockers for why radical transparency is challenging.”

If something similar were adopted by fashion brands, retailers could garner greater trust through the product lifecycle, as it could tell consumers not just where an item was made, but also who it was made by, the conditions they worked in, how much they were paid, the composition of the garment, where the fabric was grown and what chemicals had been used.

While critics of blockchain claim that it has several “Achilles heels” including problems as diverse as scalability, securing privacy and its power source, observers like Scott from The Future Laboratory are more enthusiastic. “Blockchain

powers transparency and allows brands to not only communicate their values, but also hold all of their supply chain partners and producers accountable for each step,” she says.

Clear Standards and User-Generated Insight

While full transparency remains an elusive and somewhat controversial concept, many see the immediate goal as understanding better what other steps a company can take to implement aspects of radical transparency into their operations.

Collaboration, says Fuenmayor, is the way forward — and it starts from within. “There has to be a corporate culture shift within the company so that sustainability and transparency can be achieved across all departments.” The problem, she says, is that “companies are split into departments and that causes fragmentation and silos. We need to move from a centralised system to a more decentralised one.”

Fuenmayor adds that “giving power” to employees to “make decisions” was an important step. Scott agrees, suggesting that the solution could go as far upstream in the supply chain as giving autonomy to garment workers. “It’s about putting power in their hands [and could mean] letting them upload their own conditions onto a cloud-based platform, so companies can track labour patterns a bit more honestly and authentically,” she said. “When brands want to control their supply chain and do quality control visits, a lot of [what they see through audits] is staged and not a realistic view of what’s happening.”

Meanwhile, in industries such as beauty, some manufacturers have embraced a switch to “clean label” ingredients or use of ethical certification logos, such as Fairtrade or non-GMO, to indicate that ingredients have been sustainably sourced based on explicit and established standards.

“In the long term we’re heading towards brands having to ingrain the idea of transparency into their DNA. With every new product they bring out, they’ll have to ensure that they can give all the information they can on sourcing and production,” said Blanchard. “This is going to be the future of how people shop, as more consumers are educated about the industry and will put their money in the brands they feel they can put their trust in.”

Blockchain powers transparency and allows brands to not only communicate their values, but also hold all of their supply chain partners and producers accountable for each step.

Forward-looking fashion leaders now believe that we are headed toward a future where trust becomes an exceptionally powerful currency and, extending the metaphor further, transparency then becomes as indispensable to upholding trust as the modern banking system is for managing our money.

“We mustn’t forget that transparency [itself] is not the goal. Transparency is just one step towards the aim, which is sustainability,” reminds Bonanni. “Positive change is what we should look for in the near future, which is not just for companies to be transparent, but to commit to standards across improving the supply chain.”

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Fashion System



The State of Fashion 2019

Lisi Niesner/Bloomberg via Getty Images

08. SELF DISRUPT

Technology and social media are enabling a new breed of ‘challenger’ brands that disrupt a sector or category where incumbent players have rested on their laurels. Meanwhile, to compete and stay relevant among demanding young consumers, traditional brands are echoing this dynamic and disrupting their own brands, offerings and business models.

Fashion brands, and luxury houses in particular, are often successful because of their heritage. While this continues to be a key advantage, it is no longer enough. In this year’s BoF-McKinsey State of Fashion Survey, self-disruption is top of mind for 2019, with 79 percent of executives placing it in the top five trends impacting the industry.

There are two key forces driving self-disruption: younger consumers’ preference for novelty and advancements in both digital technology and social media.

According to the McKinsey Millennial Survey, younger generations are more willing to set themselves apart through brands and they are also more likely to follow up-and-coming brands.⁸⁴ The latter will typically challenge fashion conventions through either branding, communication or distribution. At the same time, social media has dramatically levelled the playing field, allowing these “challenger brands” to disrupt the marketplace. Their emergence partly explains the 50 percent annual growth of Instagram advertising spend.

Challenger brands disrupting a sector are characterised by rapid growth, social media fluency and e-commerce focused distribution.

Clothing brand Reformation, for example, has 1.1 million Instagram followers, as of printing this report, and makes 80 percent of sales online. It pushes its green credentials and has a roster of celebrity endorsers, including Emily Ratajkowski, Selena Gomez and Rihanna. Another disruptor brand I.AM.GIA (which has created an Instagram It-girl persona called Gia) has a similar profile, with over six hundred thousand Instagram followers and a strong celebrity following. Both companies are growing sales at high double-digit rates.

If performance were measured by social media growth alone, the big incumbent fashion players would already be in trouble. Brands such as H&M, Dior and Zara grew their Instagram fan base by less than 30 percent in the year to September. Many disruptors saw their Instagram following expand by more than 130 percent over the same period, and some by more than 300 percent.⁸⁵ Earned Media Value (EMV) levels are much higher among the challenger group. Challenger brands also boast more impressive engagement; the like/follower ratio for Supreme and Everlane is 1.9 and 1.4 respectively, versus 0.3 for Dior and 0.5 for Louis Vuitton.⁸⁶

Established brands recognise that challenger brands are often more nimble and effective at reaching young audiences. In response, the former are now turning to a series of levers to “self-disrupt.”

Some established brands are embracing disruption by launching accelerators and incubators to test new approaches in a more controlled environment.

The primary lever is to conduct brand makeovers, overhauling their approach to create the impressions of having their finger on the pulse by refreshing their image. Burberry, for example, developed a new logo and monogram under Riccardo Tisci. After appointing Hedi Slimane as creative director, Celine debuted a new logo on Instagram and took a notable pivot away from the signature aesthetic to which consumers had grown accustomed and loyal.

More heritage brands are turning to streetwear brands to create a cooler image and have reflected that ethos in their talent strategies. Louis Vuitton in 2018 appointed Virgil Abloh, known for his disruptive streetwear brand Off-White, as its creative director. The origin of this type of self-disruption can be traced back to the flurry of collaborations between high fashion and streetwear players in 2017, through which a new kind of experimentation became the norm. This tendency to collaborate and flex a brand’s identity has now reached critical mass, and we expect it to persist in the future.

Other forms of disruption we see in fashion include exclusivity, faster fashion and new channels. Numerous established brands are rethinking their business models to reflect these evolutions. For instance, some are moving away from the traditional fashion calendar and

imitating the “drop” approach commonly used by streetwear labels to release smaller and more frequent collections that create rarity value and elevate anticipation. Moncler’s launch of its “Genius Project” is an example, with Hiroshi Fujiwara’s first drop driving a 43 percent month-on-month increase in earned media value (EMV) in June 2018 according to Tribe Dynamics.⁸⁷ More recently, Burberry announced its launch of “B Series,” a new series of monthly product releases on the 17th of each month.

Established luxury brands are also increasingly embracing digital channels as a primary, at times exclusive, route to market. Following the early disruptors Warby Parker and Everlane, Comme des Garçons will launch its first direct-to-consumer (D2C) only brand later in 2018 to expand its customer base.⁸⁸ We expect more established brands to follow suit.

Some established brands are embracing disruption by launching accelerators and incubators to test new approaches in a more controlled environment. These are more flexible and less risky than mergers and acquisitions, enabling experimentation and offering the opportunity to accelerate business model innovation where necessary.

In an increasingly fickle fashion environment, market leaders will also need to take more risks to stay ahead.

Kering’s second wave of Plug and Play, an accelerator focused on sustainability, is one example. Another is LVMH, which in 2018 launched its La Maison des Start-Ups accelerator programme at its Station F campus in Paris, promising to offer work stations and support for 50 start-ups each year.⁸⁹ These initiatives help major players support innovators and absorb or adapt

some of their most pioneering practices and ideas. Others are creating dedicated internal units to streamline the innovation process. Gucci Artlab, also launched this year, is an innovation hub focused on leather goods and footwear.

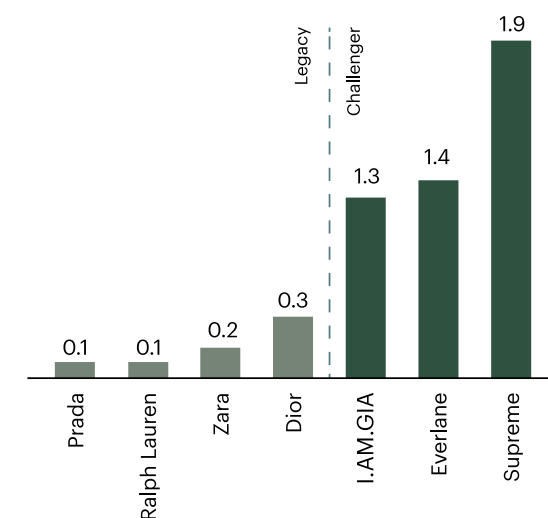
Looking forward, we see three key disruptive developments. To compete with challengers, established brands will continue to innovate, leveraging their scale to fast-track capability building through M&A, accelerators and innovation labs. The latter will help companies remain at the forefront of business model innovation and respond to new fashion trends more quickly. It will be increasingly important to adopt agile ways of working and depart from the traditional operating model. Players will also work to streamline supply chains, enabling faster time to market. In an increasingly fickle fashion environment, market leaders will also need to take more risks to stay ahead. Sub-labels will continue to proliferate, enabling brands to experiment while maintaining the authenticity of the parent brand.

Fashion brands must learn to be more willing to adapt themselves, embracing a more flexible approach to doing business in areas from commercial models to the supply chain and distribution.

Tiffany chief executive Alessandro Bogliolo summarised the mood perfectly: “We all share the same challenge — a continuous demand for change — of newness, of communication, product, everything. And this is a huge challenge because we must do it right, but we have to do it in a way that is not going to erase your personality. Constant change, but you still have to be yourself.”

Exhibit 12: **Followers of challenger brands are more active and engaged than those of legacy brands**

Instagram like/follower ratio (LFR)



Average number of likes on each post in proportion to number of followers over four weeks in August 2018.

Source: McKinsey & Company analysis based on Instagram data

The Explosion of Small

Consumers are increasingly drawn to small brands with compelling and authentic narratives. In order to keep pace, larger companies must learn how to think small.

by Jessica Moulton, Sara Hudson and Dale Kim

Conventional wisdom says that success in business is all about growth, and that in the long run Goliaths beat Davids. However, while scale continues to be an important driver of long-run value creation (see also our section on “Winners and Losers” in McKinsey Global Fashion Index), these days it does not in itself guarantee consumer appeal — so Goliaths need to find their inner David.

In many sub-sectors small brands are capturing two to three times their “fair share” of revenue growth, while the largest brands are struggling, and in some cases even shrinking. In the US, between 2016 and 2017, small brands rang up just 19 percent of 2017 FMCG sales but generated 53 percent of growth. In Europe and Australia, the figures were 33 percent and 59 percent respectively.⁹⁰

Consumer preferences and retailers’ needs both favour small. So does financing. Venture capitalists have spotted these small brands: across the whole of the consumer sector, more than 4,000 small companies have received \$9.8 billion of venture funding over the past ten years — \$7.2 billion of it in the past four years alone, a major jump from previous years.⁹¹ This funding is enabling the growth of challenger brands in niches across categories.

Fuelling the Explosion

Why are small brands growing so fast? They are capitalising on three trends — millennial

preferences, digital marketing and retailer requirements for differentiation and margin.

Millennial Preferences. Because they have become the largest consumer segment worldwide, millennials’ strong preferences are ignored by brands at their peril. Millennials crave the new, different, and authentic, while often scorning traditional brands. Millennials are four times more likely than baby boomers to actively avoid buying products from big food companies and three times more likely to see new brands as better or more innovative. In their fashion choices, millennials are almost twice as likely as baby boomers to prefer up-and-coming designers. These attitudes are spilling over into other generations as well, magnifying the impact of millennial preferences.⁹²

Digital Technology. Digital technology gives small brands an easy way to engage with consumers, who are increasingly glued to their smartphones and the internet. E-commerce provides access to the “endless aisle” that features many more brands than traditional TV advertising or store visits could. In the UK, for example, the typical superstore lists 160 SKUs of cereal; Amazon lists 1,000. The typical superstore lists 80 SKUs of shampoo; Amazon lists 2,000.⁹³

Digital also creates a host of new, cost-effective marketing channels that small brands have been especially quick to tap in order to reach and excite consumers.

Retailer Requirements. It’s not just consumers who love small brands. Because they are threatened by e-marketplaces and discounters that exert strong pressure on price, mass retailers are turning to small brands for differentiation and margin.

“It’s the smaller brands that have been better at genuine innovation — and that’s what consumers want.”

Grocers in the UK, for example, have little wiggle room on price as the top 2,000 items generate some 40 percent of sales, and retailers charge comparable prices. Enter small brands. As a UK grocer said, “It’s the smaller brands that have been better at genuine innovation — and that’s what consumers want.”

Small brands offer the differentiation that builds traffic (in the store, not just online), and they boost margin because they tend to be premium and rarely promote. In the US, 44 percent of small-brand sales are premium, versus 34 percent for other brands, helping to boost average selling prices. Similarly, only 27 percent of small-brand sales happen on promotion, versus 44 percent of large-brand sales.⁹⁴ As a result, US retailers are giving small brands double their fair share of new listings.

The Future of Small

What learnings can be captured from observing the explosion of small in the consumer sector? First, small is here to stay. Small brands fit the preferences of millennials, who will increasingly constitute the market, and the culture they have created. For example, millennials love craft beer, which they see as offering more flavour, differentiation, and authenticity — the category grew from 6 percent of total US beer volume in 2009 to 14 percent in 2017.⁹⁵

Small brands are better able to target specific market niches (e.g., vegans who require clothes

made without animal products) and respond to new market trends (e.g., free-from, athleisure or even athluxury). Moreover, digital technologies have made it easier for small brands to build awareness and sell to customers, helping them capture a disproportionate share of growth.

Second, small brands are not just froth. Some small brands will grow into sizable brands, as Kind Bars (revenue of \$727 million),⁹⁶ Halo Top (\$347 million),⁹⁷ and Fever Tree (\$220 million)⁹⁸ are doing. Other brands will be short-lived. Still others might cater successfully to a niche and thrive as small brands but never grow into mass brands. This mixed outlook calls for larger companies having enough small brands in their portfolios to replace those that languish with new brands that can compensate for the lost sales.

Global Beauty Players Are Leading The Charge

Fashion can learn lessons from the beauty industry, which is a trailblazer in this regard. Over the last decade, legacy brands such as MAC and Lancôme (at the prestige end of the market) or L’Oréal and Revlon (at the mass end) have collectively struggled to achieve 5 percent growth; challengers such as Benefit, Becca and Urban Decay have together grown at 16 percent and now have a 10 percent share of the global cosmetics market.⁹⁹

Successful small beauty companies do four things well. First, they offer high-quality, innovative products with stories that appeal to millennials. Second, they have an omni-channel presence — sometimes including subscriptions. Third, they focus on differentiating capabilities in branding, marketing and sales — often outsourcing manufacturing, distribution and even innovation.

And fourth, they claim a disproportionate share of social media. For example, Anastasia Beverly Hills has nearly 18 million Instagram followers, thanks to more than 60 posts a week and working with over 600 influencers. It aims to have a new post every three hours at peak times. This digital

In Depth

strategy generated earned media value of \$90 million in May 2017 alone. Its level of engagement — an average of 68,000 interactions per post — is equal to the combined interactions of the next top five brands (Tarte, Benefit, NYX, MAC and Too Faced). Social media firepower of this order translates into business success: Anastasia has used this Instagram presence as a springboard for explosive growth — from retail sales of just \$2 million in 2012 to current annual net revenue estimated at \$340 million.¹⁰⁰

Digital technologies have made it easier for small brands to build awareness and sell to customers, helping them capture a disproportionate share of growth.

The global beauty leaders are responding in interesting ways. They are snapping up challenger brands — Estée Lauder, for example, bought Smashbox, Too Faced and Becca; L'Oréal acquired Urban Decay, Nyx and IT. They are increasing their spending on digital and social media, including augmented reality and contracting millennial brand ambassadors and founding incubators.

Fashion May Be Well Suited to Follow

So what lessons can fashion learn from the explosion of small across the rest of the consumer sector? We see signs that the explosion of small will soon impact fashion in the same way it has transformed beauty. It is too early to say that small brands are capturing market share, but small companies are already on the rise. First, venture capital investment in apparel companies is growing. The last decade has seen 1,050 deals in clothing (more than many other sectors). VC investment in apparel and footwear has risen steadily from \$43.5 million in 2007 to \$560.6 million in 2017.¹⁰¹ But the median investment is small — private equity investment in fashion comes in at just \$500,000 (a third of the median investment in beauty, for example).

The retail mix is shifting as well. At Nordstrom, for example, small brands classified as “young” or “hot” are taking shelf space from “heritage,” “established” and “proven” brands. The small challengers make up 13 percent of the overall mix — but account for 31 percent of brand additions made in 2018.¹⁰² The playbook adopted by small beauty companies is directly adoptable by small fashion companies, particularly the emphasis on omnichannel and social media excellence. US swimwear brand Solid and Striped appears to have been made for the social media age, with about 265,000 Instagram followers (at the time of publishing), and products donned by influencers and celebrities alike. At the time of publication of this report, they are the most stocked brand in swimwear, for retailers such as MatchesFashion and Revolve.¹⁰³ Small players are also ideally suited to win by putting values at the core of their narratives (see “Getting Woke,” page 45), so that consumers can wear their hearts on their sleeves — fashion is an even better vehicle for such signalling than beauty. Online manufacturer Everlane discloses the profit on each item and how it was manufactured in a commitment to “radical transparency”.

So, if these are potential advantages for small players, can large fashion companies respond, in the same way that the large beauty conglomerates have? Again, many of the same tactics are potentially fruitful for large players — we are already seeing them buying up smaller brands to build a balanced portfolio, upping their social media game and enlisting millennial brand ambassadors. Above all, they are acknowledging the need to stay close to their new consumers. Gucci, for example, uses reverse mentoring by a group of millennial employees to inform innovation. In fashion, small is also beautiful — but you don't have to be small to behave small.

The authors work in McKinsey & Company's Consumer practice.

09. DIGITAL LANDGRAB

As the race to be the platform of choice for both customers and fashion companies intensifies, e-commerce players will continue to innovate by adding profitable value-added services and focusing on new technologies. Whether through acquisitions, investments or internal R&D, players that diversify their ecosystem will strengthen their lead over those remaining pure players who rely solely on retail margins and existing offerings.

In last year's State of Fashion report, we emphasised the importance of platforms as entry point of choice for consumers into their shopping journey. Their growing dominance through superior convenience, growing segment coverage and the launch of private labels continues to be a theme this year for both fashion pure players and multicategory platforms. For example, Amazon is on course to become the leading apparel retailer in the US, with over 8 percent estimated total share, and Flipkart has 40 percent share of online fashion sales in India.^{104,105} However, potential for profitable growth fuelled by user acquisition is starting to saturate due to market maturity and increased competition. The next horizon in platform evolution is business model diversification through proprietary technology and knowledge to enrich the offering to consumers and brands. The race is underway.

Evolution presents platforms with an opportunity to generate higher margins while growing scale, as opposed to the recent experience of fast growth without significant profitability. E-commerce players consistently post lower profits than their physical counterparts, with average EBITDA margins of -4 percent in 2017, compared

with -8 percent at traditional retailers, according to the analysis from McKinsey's Global Fashion Index. Three of sixteen publicly listed e-commerce players with revenues of more than \$100 million made a loss. In one example, Yoox Net-a-Porter posted a profit margin of -5.2 percent in 2017 while growing at 35.6 percent year on year. A series of private e-commerce players are also operating unprofitably, with Farfetch (pre-IPO), for example, reporting an EBITDA margin of approximately -14 percent in 2017, despite significant revenue growth of 74 percent.¹⁰⁶ While investors in leading players have often shown patience for profitability, weak performance has been reflected in the valuations of some small to mid-sized private players. Fab.com, once valued at \$900 million, was reportedly sold to PCH in 2015 for between \$15 and 30 million.¹⁰⁷ In 2018, Rue La La reportedly acquired Gilt Groupe for under \$100 million, far below its one-time valuation of \$1 billion.¹⁰⁸

In the context of such cautionary tales, large e-commerce players are strategically adding new services. They are venturing in areas where they have a competitive advantage, for example Farfetch and Zalando with white-labelling,

or where they spot a structural opportunity, as in Alibaba's XPressBees logistics company. They are also investing heavily in technology across the value chain, aiming to boost efficiency and streamline the customer experience. Alibaba's expansion is effectively powering the digitisation of a country's entire retail sector. This is reflected in investments in various payment solutions (Paytm, Kakaopay), logistics (XpressBees), and quantum computing cloud services (SenseTime). Among other recent initiatives, Flipkart's AI for India initiative reflects its internal use of machine learning and other advanced technologies to monitor products and spending. The initiative aims to encourage data science and promises hundreds of millions of dollars of investment to build new AI solutions.¹⁰⁹ In other examples of diversification, in 2016, Flipkart-owned Myntra acquired Cubeit, a mobile-based content aggregator, and in 2017 bought start-up InLogg, which brings together logistics vendors.

“Smaller players will continue to have their role to play as long as they differentiate on emotion, curation and trust. Not everyone needs to fit the large platform business model based on logistics, speed and search.”

In Europe, Zalando is expanding marketing and fulfilment solutions, building out its partner programme, and has acquired AI start-ups. The company, which says it wants to become the “Spotify for fashion,” is focusing its strategy on four key areas – assortment, demand generation (for example, through localised merchandising and data driven marketing), digital experience and convenience. “We want to build that one destination which is the entry point for consumers and the most relevant platform for

brands,” Zalando co-founder David Schneider told BoF in September. Non-core services are expected to contribute around 10 percent of Zalando profits in five years' time, compared with 2 percent at present, and will add at least 250 basis points to EBIT margins in the long term, according to analyst reports.¹¹⁰

Finally, Farfetch's longstanding flagship example is its Black&White offering, an e-commerce white-label solution for luxury fashion brands. This allows Farfetch to leverage its technology capability beyond its core offering. More recently, the company launched its Dream Assembly technology accelerator in April 2018 and acquired Curiosity in July to expand its social media efforts in China. “One [area] that I find interesting – and we've made a move into this – is around conversational commerce and really thinking that customers are increasingly going to have a one-to-one relationship with their shopping through text message and through one-to-one requests,” says Farfetch chief strategy officer Stephanie Phair, referring to the company's recent acquisition of a business called Fashion Concierge.

Some common threads tie these many initiatives together. Most major players have launched data and analytics offerings, the expansion of which is supported by the parent's scale and ecosystems. The supply chain is a common area of focus for innovation, as is the payments process. In addition, many have bolstered their consumer proposition through expanded private-label offerings and content platforms to generate new profitable revenue streams. Most importantly, they signal a clear intention to become the platform of choice in an increasingly competitive segment.

Still, there is room for smaller players. Stitch Fix chief operating officer Mike Smith says, “smaller players will continue to have their role to play as long as they differentiate on emotion, curation and trust. Not everyone needs to fit the

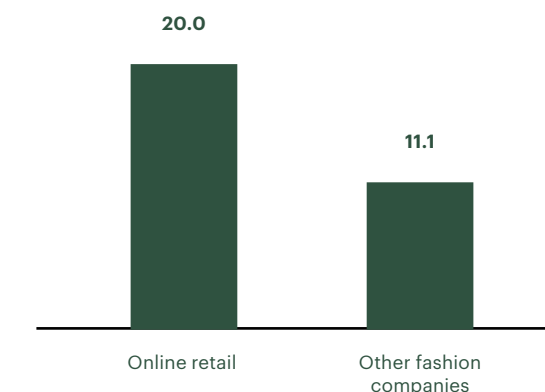
large platform business model based on logistics, speed and search.”

Looking ahead to 2019, we are likely to see an accelerated emergence of ecosystems of related and overlapping businesses. There will likely be an intensified race for pole position, with the largest players battling to become the go-to platform for consumers and brands. The “holy grail” of the industry will be integration of value-add services that remove friction in the consumer and supplier journey through effective use of data analytics at scale. This could lead to a continued wave of M&A activity in a race to find the best complementary offerings for existing platforms. There is also a rising chance of some kind of shake-out for vertical pure players, catalysed by reduced valuations and the failures of some smaller companies. Where generalist e-commerce platforms remain focused on retail margins rather than ancillary services, without occupying a niche, the demise is likely to come sooner rather than later.

“One [area] that I find interesting is around conversational commerce and really thinking that customers are increasingly going to have a one-to-one relationship with their shopping through text message and through one-to-one requests.”

Exhibit 13: **Valuations of online retail players are significantly higher than traditional retail**

2017 average market capitalisation to EBITDA multiples



Based on averages of publicly listed fashion retailers with \$100m+ annual revenue. Source: McKinsey Global Fashion Index (MGFI)

Nick Beighton

Chief Executive of Asos



The chief executive of Asos talks about the race to build the best ‘conversational interfaces,’ the next big battle between e-commerce players, Brexit and his change of heart on AI.

— *by Robb Young*

BoF: Few sectors of the fashion industry are developing as fast as yours. What do you see as your biggest challenges and opportunities in 2019?

NB: The market has got too big a supply and capacity of stores [so] 2019 is going to be the year when that changes. Demand for clothing has largely been flat around Western Europe, but where people are choosing to spend their money, their time [and] their effort, is going to move increasingly into a different channel.

That means digitalisation at an ever-increasing pace. There will be all kinds of different [digital] interfaces with brands — which will be AI-driven — through voice, through visual, through direct messaging. My tech people call them ‘conversational interfaces.’ I use the language of customers and go, ‘Imagine interacting with your brand 24/7 in any way you want, with

a picture, with voice, with direct message, through WhatsApp, through an email if you want to, and the digital brand responds to you.’

Other big [factors to watch] will be the impact, certainly European and UK, on disposable incomes, post-Brexit. Depending where we end up [with Brexit], there’s going to be an impact on supply chains and there [could be] friction and costs associated with all of that.

BoF: In the past, you’ve said that mobile is the future and that you’re going to go wherever mobile goes. Were you referring to the kind of ‘conversational interfaces’ that you just mentioned?

NB: Yes, that’s exactly what was in my mind. Seven years ago, we started our mobile journey. Today we’ve got the best part of 80 percent of our traffic in the UK coming from a mobile device, and the other major territories are catching up quickly. Using your mobile device to shop and interact with your favourite brands in a different way is going to be the next new challenge, which is the ‘conversational interface.’ The friction of swiping around with your thumb on a mobile device is just as much friction as tapping around a keyboard. Twenty-somethings are looking at their mobiles between 150 and 200 times a day. It’s a high frequency, high velocity channel and... an easier and more intuitive way for customers to interact with e-commerce [but] there is still friction.

BoF: What about ancillary services? In the context of retail margins, a lot of the big online players are diversifying into complementary services that are not core to the retail function. Is this something that you foresee as part of the Asos ecosystem of the future?

NB: I don’t yet, actually. The Asos margin has been 4 percent for four years, and we set it at four percent EBIT margin to allow us to invest in customers, products and innovation and to be experimental, so, I don’t necessarily see retail margins falling in my world. Now, I do believe other businesses that have set themselves higher EBIT margin targets, they’re going to have to respond, because, if, on average, a clothing retailer has a 15 percent EBIT margin, and I’m prepared to operate on four, there’s 11 percent that I can invest in growth drivers, so I do think there’ll be some pressure on EBIT margins, or other brands will just have to choose not to go for growth. It’s certainly not our model, though, so I don’t see ancillary services in terms of Asos, but I see other platforms and brands doing that.

BoF: You’ve been investing big in beauty. How do you manage to differentiate yourselves from other players in the beauty space?

NB: Well, let me tell you the words of a significant chief exec of a large beauty business who turned around to his board and said, ‘Asos can redesign the role of beauty for 20-somethings in the same way they’ve redesigned the role of fashion for 20-some-

things.’ That’s exactly what we’re aiming to do. When you think about beauty and grooming with Asos — we call it Face and Body now — this won’t be somewhere you get your functional requirements for cosmetics. This will be where you get excitement and engagement that is content-rich, brand-rich and also Asos product-rich through great delivery experiences and great digital experiences. This is something that hasn’t yet been done.

BoF: When you first took on your leadership role, you said that Asos won’t be growing up with your customers, and that you want the brand to remain ‘forever young.’ How do you do this but avoid alienating your older customers?

NB: Focus is important to us, and our experience is delivered by a mostly twenty-something audience. Our 18.4 million active customers are mostly twenty-somethings. Thirty percent of our customers have been over 30 [since the beginning,] but our tone of voice, product, price, experience, content, it’s all driven for twenty-something engagement. That doesn’t mean we’re not interested in over-30s anymore, it just means we recognise that some of our products and experiences may lose relevance as you progress through your life. If this wasn’t e-commerce, we would be looking at a different proposition for a different demographic. But because this is e-commerce... we will stay twenty-something; we will stay ‘forever young.’

BoF: A number of your online peers have been venturing into physical retail for a number of years. What is your take on that and will it feed into Asos's future in the years to come?

NB: It's not our mission, currently. We have 85,000 major SKUs on our ecosystem, that's 500,000 SKUs at a minor level. Our proposition is about content, about technology, it's about product. A digital manifestation of that is very clear, but physical manifestations of that are less clear, so, I don't envisage a physical store any time in the short-term. Never say never, experimentation is always key, but it's not something we are currently looking at to achieve our mission.

BoF: A lot of the discussion around artificial intelligence in e-commerce players, and fashion more broadly, seems to be around getting the balance right between AI and the human touch. What is the right balance mean in Asos' world?

NB: I used to say, 'Be careful when you put a machine in front of a human, because you'll lose something.' But I've migrated my view on this a little bit. Now, I actually think putting a machine in front of the human — with the right context — is a great thing. It's something that we'll only figure out through experimentation. Where I see AI working for us is in two ways; one, to enhance and turbo-charge

customer experience, in terms of recommendations, different ways of doing search, different ways of engaging with our ecosystem, and two, improving the cost of handling all our customer queries and all our products through our entire end-to-end business.

BoF: What do you think are the most important technological advances in the year to come?

NB: Without a shadow of a doubt, something that improves size [and] fit, for customers and brands would be an absolute game-changer. It's about; 'Here's my body shape, how can I match my body shape to the products on sale in a way that I don't have to worry about returns?' That will be a game-changing piece of technology, but I don't know what the real deal is, in terms of a solution. I've looked at lots of different manifestations that are getting close. I've looked at avatar solutions, I've looked at uploading pictures of yourself, I've looked at other solutions using data analytics to recommend... We've got one of

"Using your mobile device to shop and interact with your favourite brands in a different way is going to be the next new challenge, which is the 'conversational interface.' The friction of swiping around with your thumb on a mobile device is just as much friction as tapping around a keyboard."

those live right now. [But it's got to be] something that's engaging, intuitive and helps customers resolve that simple problem.

BoF: What about the pain-points for customers between discovery and purchase? Is your visual search function part of the solution to overcome that friction?

NB: There is friction [and] visual search is one of those things that will help it. You go to dinner with your boyfriend or girlfriends, take a few snaps of your outfit, upload, and go, 'Has Asos got something similar?' 'Yes, it has, available on next-day delivery.' 'Brilliant.' Visual search is one of the ways to take away that friction, but, by far and away, the biggest friction is the sizing debate. Most customers will tell you that they get frustrated by a size ten being something different in each and every brand, and the annoyance of having to send something back because it doesn't quite fit, so, something that assists customers with that problem will be pretty big for us.

This interview has been edited and condensed.

10. ON DEMAND

Automation and data analytics have enabled a new breed of start-ups to adopt agile made-to-order production cycles. Mass market players will begin to follow suit, aiming to respond more rapidly to trends and consumer demand. The result is likely to be a rise in just-in-time production, reduced levels of overstock and the rising importance of small-batch production cycles.

Design and production are typically a long and cumbersome process, sometimes requiring nearly a year to plan and move products to market.¹¹¹ Technology, analytics and nearshoring are part of the solution, enabling companies to respond quickly to source and develop products, squeeze production timelines and streamline distribution. Start-ups are at the vanguard of this, but some mainstream players are also stepping up and delivering.

The power of social media means trends are now more often established by consumers, as opposed to retailers and editors. In an era of fast-changing preferences, being able to respond to shifting demand, and tailor production accordingly, makes a lot of sense. Fashion is seeing the start of a seismic shift where products are "pulled" into the market based on actual demand rather than "pushed" based on best-guesses and forecasts. The change is significant. Previously, procurement, production and distribution were predicated on designer and buyer predictions of future consumer demand. Products were produced and marketed in traditional "seasons." Under the "pull" dynamic, procurement, production and distribution are based on

customer demand. There is an accompanying "supermarket" model, by which inventory is only replenished once consumed.

From an economic perspective there are positives and negatives to on-demand production. On the plus side, it requires lower capital investment, and leads to smaller inventories and more flexibility and agility. Shorter-turnaround cycles can reduce demand uncertainty and contribute to a more sustainable small-batch production cycle. However, production costs are generally higher, due to the smaller batch sizes, as are transport costs if production is nearshore or offshore. Nonetheless, companies including Zara, Boohoo and Asos have embraced the model.¹¹²

The switch to "pull" can be boosted by moving production closer toward nearshoring and onshoring, enabling same day production and next day delivery. This is a far cry from the past, when lead times from design to retail were counted in weeks rather than hours. According to a study by Goldman Sachs, there is a direct inverse correlation between supply chain lead times and like-for-like sales growth. Equally, industry executives expect nearshoring to grow. According to recent survey results published by McKinsey,

60 percent of apparel procurement executives expect that over 20 percent of their sourcing volume will be from nearshore by 2025.¹¹³

A related enabler is automation, which for some products will offset the cost disadvantage of procuring closer to home. While apparel manufacturing automation may still be subscale, technologies being developed show its massive potential. Stand-outs include digital and laser printing for finishing (allowing for nearshoring for final touches combined with automation or low-cost sourcing of the basic garment), knit-innovations (e.g. 3D knitting), semi-automated sewing and automated logistics.¹¹⁴ These can help companies reduce labour intensity, do more customisation, improve reliability and cut process times.

Fashion is seeing the start of a seismic shift where products are “pulled” into the market based on actual demand rather than “pushed” based on best-guesses and forecasts.

Another opportunity is in microfactories, which enable high speed, agile garment production. They are used in the design studio to speed up the prototyping process, or on the shop floor, to provide high customisation and zero waste. According to Lisa Lang, founder and chief executive of ThePowerHouse, a fashion-tech agency, “microfactories will take off on the next few years and there is evidence of a few players already developing them.”

Start-ups are taking advantage of these technologies to produce garments “on-demand.” Berlin-based Lesara, for example, produces 90 percent of products in-house, and claims a 10-day turnaround time from identifying fashion trends to putting products on the market. Technology

players are also contributing. Companies such as Softwear and Sewbo have revolutionised garment production machinery, using robotics to fully automate sewing. Sharecloth, a New York based software company, contributes to on-demand by digitising styles and enabling retailers to place orders before products are ever manufactured.¹¹⁵

Adidas is one of a group of large brands that are showing signs of leveraging speed to shift towards on-demand. Aside from its Arkansas operation, it operates “Speedfactories” in Atlanta and Germany that together are expected to produce around a million pairs of running shoes a year by 2020, using digital design to enable mass customisation.¹¹⁶ Superdry launched “Superdry Preview,” limited-edition collections that will go from design to delivery in just 6 weeks.¹¹⁷ In 2017, Amazon secured patents for a fully automated, “on-demand manufacturing system” for apparel.¹¹⁸ Uniqlo parent company Fast Retailing has signalled its intent to produce on-demand knitwear at scale through its partnership with Shima Seiki.¹¹⁹ Shima Seiki produces 3-D knitting and technology it labels “Wholegarment,” which produces seamless knitwear and requires no post-production labour, and anticipates that its tools and machines will enable “mass customisation.”¹²⁰

Major players are also leveraging advanced analytics to revolutionise the planning and production process. In some cases, this is enabling garment customisation on a mass scale. For example, in late 2017, Japanese online player Zozotown launched “Zozosuit,” a body scanner that could take measurements for made-to-fit jeans, T-shirts and suits. Founder and chief executive Yusaku Maezawa expects Zozosuit to revolutionise the scale of personalisation. “People see the Zozo brand as providing clothing specifically tailored to individuals,” he told us, “so we’re looking to create a presence that closely resembles that infrastructure. We’d like to get to where

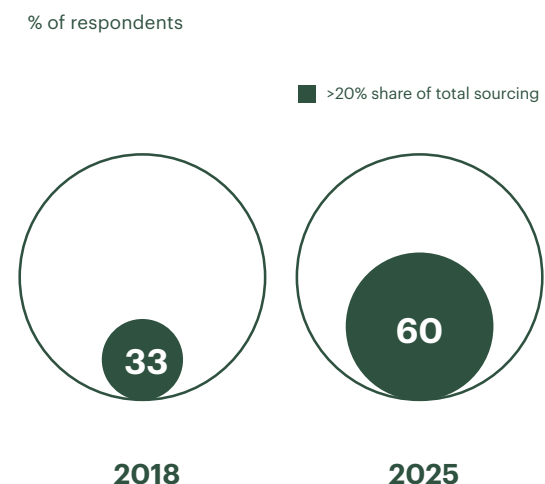
people associate us with clothing made to fit the shape of the body.” The company expects to sell six to ten million suits within the year.¹²¹

Strategically, however, there are differences between start-ups and leading brands. Rather than jump into on-demand fashion, established companies are likely to proceed step by step. This is partly because there is a high cost and disruption to actions such as radical supply chain transformation.

60 percent of apparel procurement executives expect that over 20 percent of their sourcing volume will be from nearshore by 2025.

In the coming year we expect to see continued investment in speed (both through capability building and M&A) via more onshoring and nearshoring, virtual sampling, microfactories (rapid prototyping) and automation. Reduced lead times will be key drivers of competitive advantage. Small-scale players will likely lead the way, while larger brands pilot in selected markets. We expect rising take up of on-demand will lead to a spike in personalisation, and a new generation of customised clothing start-ups, creating a new definition of “made-to-measure.” In the technology space, automation intellectual property will continue to develop, with patent approvals likely to be a critical success factor in the years ahead.

Exhibit 14: **Survey respondents’ aspiration level for a shift to nearshoring**



Source: McKinsey & Company

Is Apparel Manufacturing Coming Home?

To meet customers' needs, apparel companies need to focus on nearshoring, automation and sustainability.

by Johanna Andersson, Achim Berg, Saskia Hedrich and Karl-Hendrik Magnus

Two decades ago, US and European mass-market apparel brands and retailers rushed to shift production to Asia to gain a cost advantage. Since then, they have doubled down on this low-cost strategy, moving production from China to even more cost-efficient frontier markets. Apparel players that have successfully done this, while still ensuring high quality, speed and compliance have traditionally been able to deliver products that consumers want, at competitive prices.

Now, however, a perfect storm of factors is changing this calculus by making it critical for companies to bring new styles to market more quickly and switch out lines mid-season. Internet shopping and stagnation in key markets have made competition fiercer than ever and consumer demand more volatile and difficult to predict. Mass-market apparel brands and retailers are competing with pure-play online start-ups, the most successful of which can replicate popular styles and get them to customers within weeks. Furthermore, apparel companies' marketing departments have lost much of their clout in trendsetting, with today's hottest trends now determined by individual influencers and consumers.

The pressure for smaller batch sizes and on-demand replenishment is driven partly by profitability, but also by a desire for sustainability. Consumers are becoming increasingly aware of the environmental impact of traditional linear

apparel production modes, and public outcry around overstock liquidation is becoming louder (about three percent of unsold apparel is liquidated).¹²² Some 78 percent of sourcing managers responding to our survey believe that sustainability will also be a somewhat or highly likely key purchasing factor for mass-market apparel consumers by 2025.

Mass-market apparel brands and retailers cannot win in the next decade without transforming to a demand-focused model. Apparel companies are optimising and digitising their processes and rethinking inbound logistics. One new strategy is to optimise the apparel production model, including elements such as nearshoring, automating new delivery models around customisation, and shifts toward sustainable, circular value chains.

Nearshoring Opportunities and Challenges

In addition to concerns about the ecological footprint of offshore sourcing, rising wages for factory workers across Asia mean production in the Far East is no longer as cost-efficient as it used to be. For instance, labour costs in China in 2005 were one-tenth of those in the US; today, they are about one-third. In some nearshore markets, the gap between nearshore and offshore labour costs has disappeared: today, for example, Mexico offers lower average manufacturing labour costs than China. In nearshore countries for the Western

European market, manufacturing labour costs are still higher than those in China, but the gap is shrinking: whereas hourly manufacturing labour costs in Turkey were more than five times higher than those in China in 2005, in 2017 the gap was only 1.6 times.

Digital technologies have made it easier for small brands to build awareness and sell to customers, helping them capture a disproportionate share of growth.

And that's before transportation is taken into account. Today, even from a mere landed-cost price perspective, nearshoring can be economically viable in certain cases due to savings in freight costs and customs duties. For instance, a US apparel company that moves production of basic jeans from either Bangladesh or China to Mexico can maintain or even slightly increase its margin, even without higher full-price sell-through. For Europe, as another example, reshoring from China to Turkey can reduce landed-cost prices for denim by 3 percent. Nearshoring works where full onshoring doesn't: bringing production back to the US or to Germany will not yet result in breaking even. From a landed-cost perspective it is becoming more attractive for production to move closer, but not to come all the way home.

But the real prize is shorter lead times. By reducing time-to-market, companies can produce more closely in line with demand, reducing overstocks and increasing full-price sell-through. For example, increasing full price sell-through by 5 percent as a result of shifting to demand-focused processes not only makes nearshoring in Mexico even more attractive, but also takes US onshoring to break-even. In this paradigm, sourcing considerations move from a focus on cost alone to a focus

on increasing the net product margin and on avoiding wastage.

Despite its attractiveness, the apparel manufacturing industry in nearshore countries in the Americas, Turkey, Eastern Europe or North Africa still lags the Asian manufacturing powerhouses. The current import volume from the five biggest nearshoring markets to the US, for example, does not even account for half of the US imports from China. The industry is more fragmented and quality and labour productivity in some nearshore countries is more volatile.

Nearshoring also creates a new set of trade-offs and challenges with regards to industry structure, productivity, operating model, sustainability and supply. The biggest challenge currently is sourcing raw materials, fabrics and ingredients for mass-market apparel. Only a co-located value chain can offer the full speed and flexibility promised — without it, the longer lead times just shift further up the value chain. However, the current bulk of production and consumption of the main fibre types is still centred in Asia, especially China. In nearshore countries for the US and European apparel markets, existing capacity is limited. Local yarn and fabric supply in Europe, for example, is better suited to upmarket clothes than to mass-market. Overall, 63 percent of respondents believe that fabric production will likely move toward nearshore locations by 2025 to support regional supply chains. To attract manufacturers to invest in building the capacity, apparel brands and retailers will need to act as true partners and commit to order volumes. The discussion of regional supply chains is gaining additional traction in light of innovations in sustainability and closed-loop recycling, such as re:newcell. Approximately 80 percent of respondents from our dedicated survey believe that closed-loop recycling will scale up in the future.¹²³

The Potential for Automation

Nearshoring and automation go hand-in-hand. Nearshoring – and, in some cases, onshoring – will make even more economic sense as technology develops, because automation will increase labour productivity and offset higher labour costs in near- and onshore production. Mass-market apparel brands and retail buyers will consider automation capabilities when deciding where to manufacture products in the future, in addition to the commercial importance of shorter lead times and cost efficiencies mentioned above. Local governments and garment industries in nearshore and onshore locations will also need to build the skills and capabilities needed for advanced manufacturing among their workforces.

To date, the apparel industry lags other sectors when it comes to automation. Neither automation nor advanced manufacturing have been a priority for apparel buyers. One reason is that they have relied on relatively low labour costs in the core Asian and other low-cost sourcing markets. Automation also presents technical challenges, especially in sewing; only recently have fully-automated solutions for sewing become market-ready. But now, as on-demand production gains importance and technologies develop, automation is becoming more relevant for US and European mass-market apparel players, especially combined with near- and onshoring. Recent advances in technology span the whole gamut from sewing to gluing, knitting and finishing to warehousing and intralogistics.

Our research shows a clear message: for certain products, automation will not only make nearshoring more attractive for US and European mass-market apparel brands and retailers, but it will also make onshoring to the US economically viable in the future.

The overall impact is considerable: assuming all key technologies currently in development are implemented in the future, about 40 to 70 percent of labour time can be reduced through automation.

From a pure cost perspective, automation levels the playing field and makes Mexico cost-competitive with Bangladesh. Even onshoring from China to the US achieves breakeven from a pure cost perspective if the optimistic 70 percent labour time reduction can be achieved. For European markets, the economic viability of near- or onshoring also improves with automation. Onshoring to a higher labour cost country such as Germany, however, does not break even in any of the scenarios. When additional commercial benefits arising from increased speed and flexibility are added to the mix, the case for implementing advanced manufacturing technologies in near- and onshoring markets is even stronger.

The next decade will be critical for the adoption of automation. Executives are bullish about the future of automation. In our survey, 82 percent of respondents believe that simple garments will be fully automated, leading to an 80 percent labour reduction by 2025. Seventy percent think that it is highly or somewhat likely that more complex garments, such as dresses and jackets, will be significantly automated (resulting in a 40-percent labour reduction.)

Within five years, semi-automated factories could enable nearshoring and selected lighthouse projects of new business models, such as store factories, that could help build customer excitement. Within five to ten years, suppliers with fully automated factories could enable full

onshoring. More complex silhouettes will be semi-automated within a decade.

Sustainability

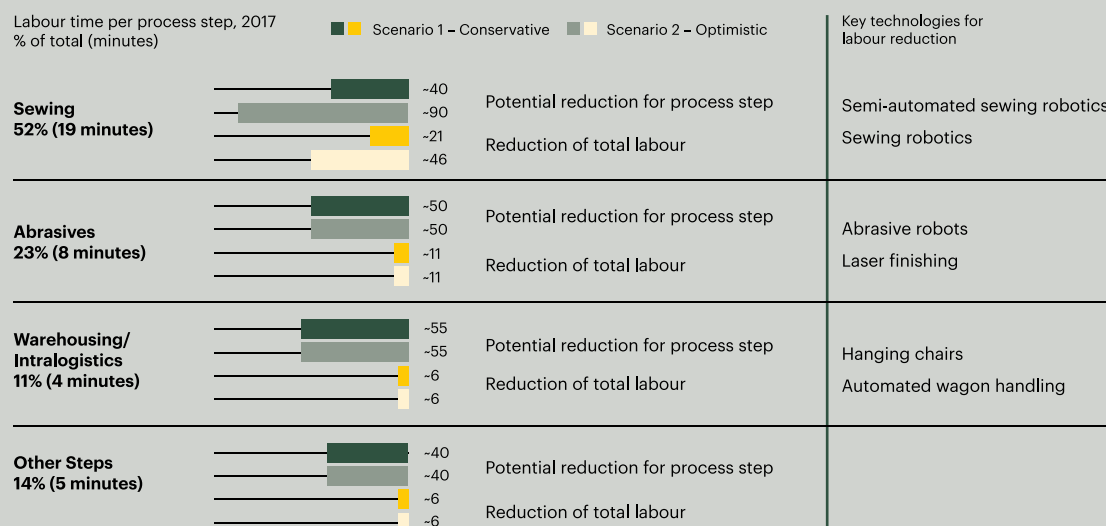
Nearshoring and automation have environmental and social benefits, in addition to the commercial benefits described above. By bringing production closer to home and investing in advanced manufacturing, companies in the apparel sector will become more sustainable and less wasteful by reducing overproduction and decreasing the ecological footprint from reduction of transport. Taken together, nearshoring and automation could enable a circular value chain.

How to Get Started

Looking at the trajectory of both consumer preferences and the development and adoption of automation technologies, mass apparel brands and retailers should embark on the journey toward a demand-focused value chain now or risk losing touch with their consumers. To position themselves for success, they need to take four actions: define their future sourcing and production strategy, nurture new skills and capabilities, build an ecosystem of partnerships and dig in to accelerate the learning curve.

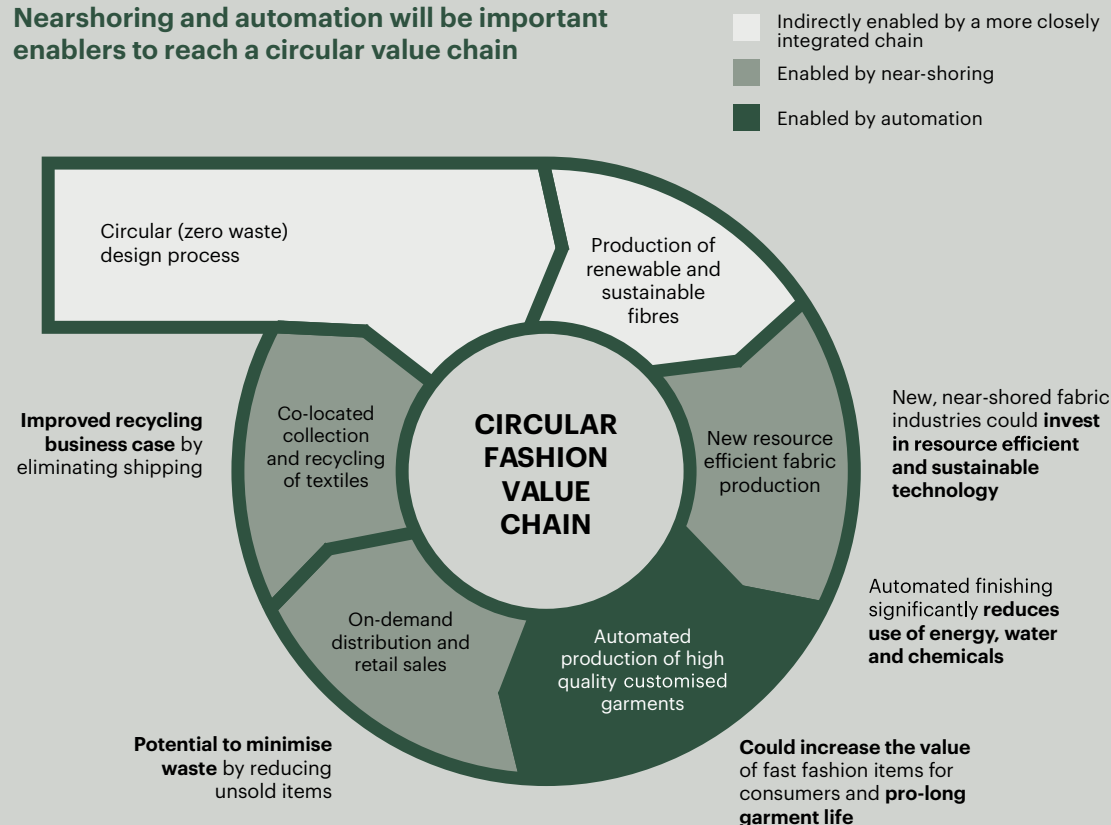
Strategy. Knowing where they want to go and how to get there will be crucial for mass-market apparel brands and retailers. Nearshoring and automation will not make financial sense for every single product. Decisions on the future production footprint of each product type should be based on two main criteria: the feasibility of nearshoring and the commercial value of reducing lead times. Companies should model different financial scenarios to develop a fact base that guides their strategy.

Exhibit 15:
Automation of sewing will be the biggest driver of labour reduction



Source: McKinsey & Company and ITA at RWTH Aachen

Exhibit 16:
Nearshoring and automation will be important enablers to reach a circular value chain



Source: McKinsey & Company

Labour intensity and automation feasibility vary greatly between different product and design types but are mainly driven by the same characteristics: for instance, number of pieces, finishing and intricate details, movement of parts and type of raw materials. Taking these factors into account when classifying a product helps mass-market apparel brands and retailers establish a high-level view of what the future holds when it comes to the sourcing and production footprint.

Skills and mindsets. A new, demand-oriented supply chain requires a very different mindset and skillset – more consumer oriented and more agile. The traditional approach of cost orientation from more traditional sourcing optimisation will not be sufficient.

Access to talent will be a major success factor in creating the supply chain of the future. The biggest talent gap today is likely in digital or advanced manufacturing and managing intelligent sourcing decisions in the more complex apparel value chain. Brands and retailers will need more talent who can

develop or identify winning technologies, making the decision on where to build new technologies themselves versus forming partnerships or acquiring new capabilities.

Partnerships. In a world where innovation is taking place at breakneck speed and where there is still uncertainty about which technologies will create real value, partnerships will be critical for building a sustainable competitive advantage. Apparel brands and retailers will need to forge relationships with global mega-suppliers to build manufacturing capacity and capabilities in new geographies. They will also need to collaborate with technology companies to develop innovative automation solutions since, currently, neither apparel brands nor (most) manufacturers are likely best positioned to develop disruptive technologies.

Financial partners such as private equity or venture capital firms can also play a critical role in the ecosystem, making capital investments to build local end-to-end supply chains in frontier nearshore countries.

Digging in. Starting the nearshoring journey now, rather than waiting for automation to further improve the economics, is critical for those who want to leapfrog the competition. Nearshoring some product lines and categories already makes economic sense; even for product lines that are not yet economically favourable, it could be a worthwhile investment for brands to make a slightly lower profit to gain an edge on competitors.

In addition, apparel companies should place several bets, e.g., collaborate with manufacturers, invest in technology firms and recruit talent for in-house engineering. Technological advances have pushed automation in apparel manufacturing to the brink of a breakthrough, and further investment could very soon lead to a disruption. Apparel companies that are active in driving the development should expect to see great returns.

The disruptions ahead are so profound that mass-market apparel players making big moves and capturing the advantages of nearshoring and automation will have a significant first-mover advantage. The business models they build will drive growth and be difficult for others to replicate. As it turns into a source of competitive advantage, sourcing and supply chain management has completed its journey from mere savings generator to focus topic on the chief executive agenda. Although apparel manufacturing may not be coming home in the near future, some of the production will at least be moving ever closer – and mass-market apparel brands and retailers will want to be prepared.

The authors work in McKinsey & Company's Apparel, Fashion & Luxury practice.

McKinsey Global Fashion Index

The State of Fashion 2019

The McKinsey Global Fashion Index (MGFI) is composed of over 500 public and private companies spanning all geographies, segments and product categories. It was created to track the industry’s performance through three key variables — sales, operating profit, and economic profit — providing a holistic benchmark for the fashion industry.

The MGFI was introduced two years ago in the State of Fashion 2017 report to fill a gap in the coverage and understanding of performance in the global fashion industry. While fragments of the industry — such as particular segments or categories — had been tracked before, the MGFI provided the first bird’s-eye view of the whole market. The index tracks financial development across six price segments: luxury, affordable luxury, premium/bridge, mid-market, value and discount (see glossary). It includes six product categories: clothing, footwear, athletic wear, bags and luggage, watches and jewellery and other accessories.

The MGFI tracks and forecasts sales and operating profit. As only source in the industry MGFI also analyses historical economic profit — a measure of value creation that takes into account how much each company had to invest to generate its performance (see glossary).

For the first time this year, we took a closer look at the drivers of economic success in the sector. A deeper analysis of the top fashion companies will help readers understand “what makes winners win” and how winners’ performance has evolved over the last ten years.

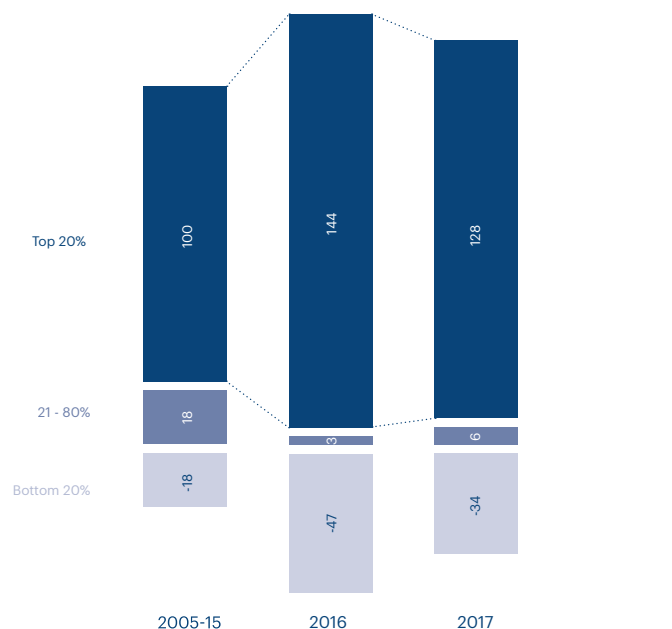
The rise of the ‘super winners’

The good news for the industry is that 2017 was a record-breaking year for overall value creation among listed fashion companies, with aggregate economic profit reaching its highest levels for 10 years, after a steady decline between 2012 and 2016. This was driven by a particularly strong upswing in revenue growth for publicly listed companies, resulting in improvements in capital efficiency as invested capital grew at a slower pace than revenues. Investors recognised this strong performance, driving share valuations to an all-time high. And this was not just part of an overall stock market trend: between 2008 and 2017, fashion sector equity returns have beaten both the S&P 500 and MSCI world indices.

We observed in past editions of this report that fashion is a winner-takes-all industry. However, after a period of accelerating outperformance, leaders in 2017 gave up some of their advantage. The top 20 percent of companies attracted 128 percent of economic profit in 2017, compared with 144 percent in 2016. Still, polarisation has clearly not gone away and scale continues to matter. While a subset of companies continues to account for the majority of economic profit, the

Exhibit 17:
The top 20 percent of fashion companies generated 128 percent of industry economic profit

Fashion companies' contribution to industry economic profit 2005-2015 vs. 2016 vs. 2017 %

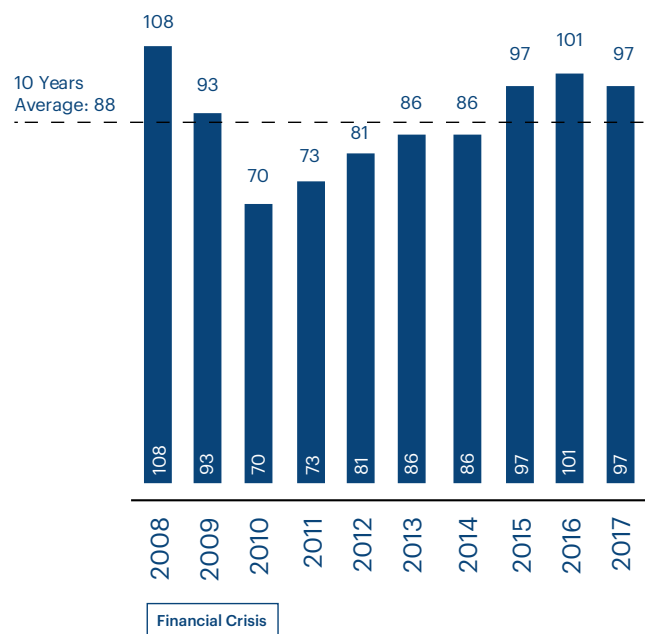


Based on publicly listed companies.

Source: McKinsey Global Fashion Index (MGFI)

Exhibit 18:
Top 20 fashion companies' contribution to industry economic profit 2008-2017

%



Based on publicly listed companies.

Source: McKinsey Global Fashion Index (MGFI)

number of “value-destroying” companies (i.e., companies generating negative economic profit) has almost doubled between 2010 and 2017.

This polarisation has led to an even smaller group of “super winners.” In fact, over the long term taking the top 20 companies as a sub-group, there was a widening disparity with the remaining companies encompassed in the top 20 percent. These “super winners” now account for 97 percent of economic profit, compared with 70 percent in 2010: this suggests they are increasingly dominating the global value pool. This is a global phenomenon that can be observed across industry sectors (beyond fashion), regions and cities, as outlined in McKinsey Global Institute’s recent “Superstars” study.¹²⁴

By segment, we also continue to see polarisation, with luxury and value advancing and mid-market players falling behind. Companies able to differentiate on price point/efficiency or brand have performed best. Outstanding performers included handbag and luggage makers and own-brand multi-category players. Well-known European luxury companies tended to be overrepresented in the top 20, with North American companies coming in a close second. Notably, the top 20 group of companies has remained stable over time. Twelve of the top 20 have been a member of the group for the last decade. Long-term leaders include, among others, Nike, LVMH and Inditex, which have more than doubled their economic profit over the past ten years — according to MGFI estimates each racked up more than \$2 billion in economic profit in 2017. The most resilient winners included luxury, sportswear and fast fashion players, reinforcing the point that brand investment and operational efficiency are key drivers of sustainable business models. Over time North American department stores lost out, with none remaining in the top 20, compared with three 10 years ago — a stark illustration of the fragility of the traditional retailing model. Notably, online players have yet to break

into the elite group, with only two players in the top 20 percent and none in the absolute top 20. Their average top-line growth is four times higher than that of other fashion players, but this tends to translate only into valuation multiples (twice as high as average) while profitability still lags behind.

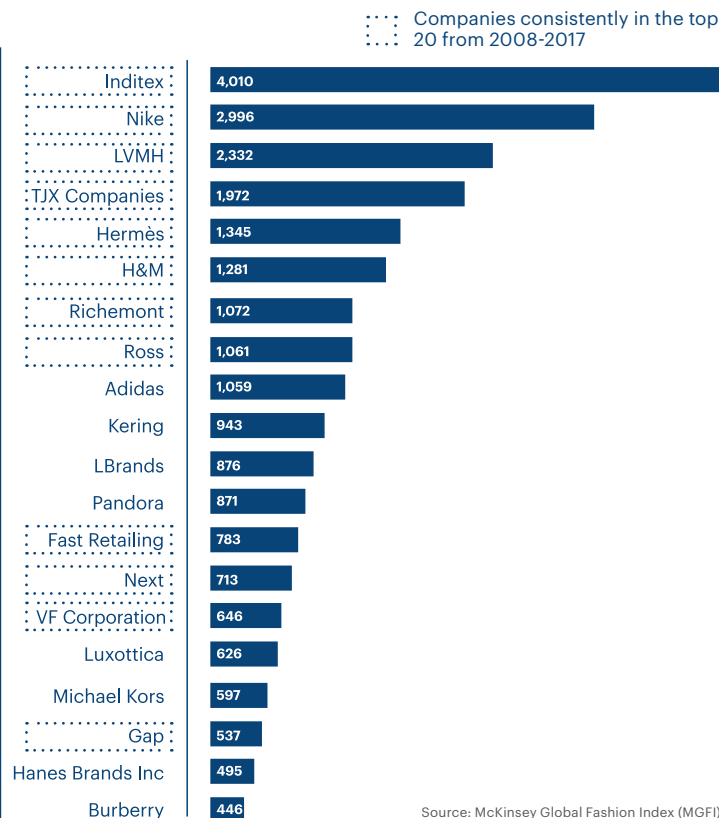
Looking at drivers of long-term success, we find that profitability and capital efficiency are key: winners all had above-average EBITDA margins and most exhibited below-average invested-capital-to-revenue ratios, while the percentage of revenue growth was in line with the wider sample.

Still, the lesson from 2017 is that size continues to matter. There is a demonstrable advantage to scale. The one caveat is that if you can't be big, be nimble: challengers that have identified a niche have also found favour. The strategic implication is that executives must be decisive on the source of economic value creation. The most likely route to success, based on recent experience, is to invest either in brand strength or in operational efficiency to produce faster or at a lower cost.

Sunny intervals but storms ahead

Looking ahead to 2019, we see many opportunities for the fashion industry — but also many risks. The latter emanate mainly from the evolving macroeconomic environment and the potential for disruption from shifting trading relationships (see trend articles on “Caution Ahead” and “Trade 2.0” for more background.) It is useful to view the industry’s potential future through four separate lenses, each of which offer a perspective on the most important drivers of growth and key topics covered in this report. The lenses are industry and regional performance, market segment performance, product category performance and overall operating profit performance.

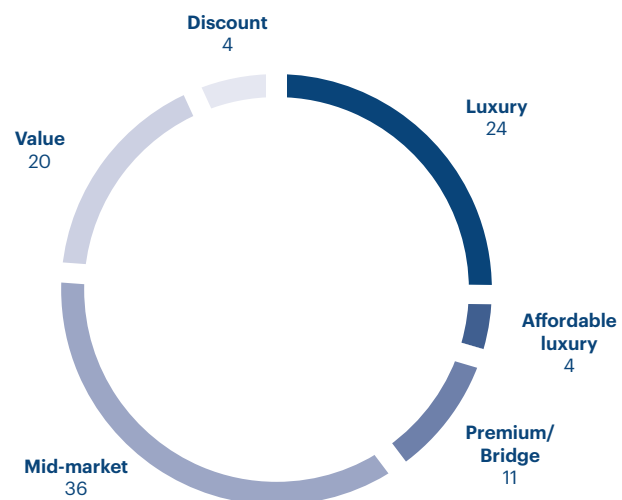
Exhibit 19:
The “super winners”
 Top 20 players 2017,
 By economic profit, \$US million



At adjusted 2017 FX rates.
 Based on publicly listed companies.

Source: McKinsey Global Fashion Index (MGFI)

Exhibit 20:
Economic profit distribution by segment
 Total economic profit by price
 segment, 2017
 % of all public companies



Due to rounding, numbers presented may not add up precisely to 100.
 Based on publicly listed companies.

Source: McKinsey Global Fashion Index (MGFI)

Industry and regional performance. We predict industry growth of 3.5 to 4.5 percent in 2019, slightly below our 4 to 5 percent estimate for 2018, when the industry was bouncing back from a relatively weak period. Continuing the trend of recent years, players in emerging Asia Pacific and emerging Europe will lead the way; however, emerging Asia Pacific is likely to continue its strong performance in 2019, while emerging Europe will probably slow slightly from 2018. Mature Europe and North America will also see slightly slower growth. The overall impact will be slightly less robust global industry growth than in 2018. We see Latin America (in particular Brazil), Middle East and Africa and Russia experiencing more economic and political challenges that are likely to dampen their consumer spending.

Value segment performance. As in previous years, we expect the best-performing segments in 2019 to be luxury, fuelled by fast-growing Asia Pacific economies and the continuing boom in global travel, and value, fuelled by strong propositions globally. Prospects for affordable luxury are likely to be more fragmented, with some regions expecting above-average growth (e.g., emerging and mature Europe and China), while others such as Japan, Latin America and North America underperform. Premium/bridge and mid-market players are most likely to struggle, in the face of strong competition from value/discount players and increasing market saturation.

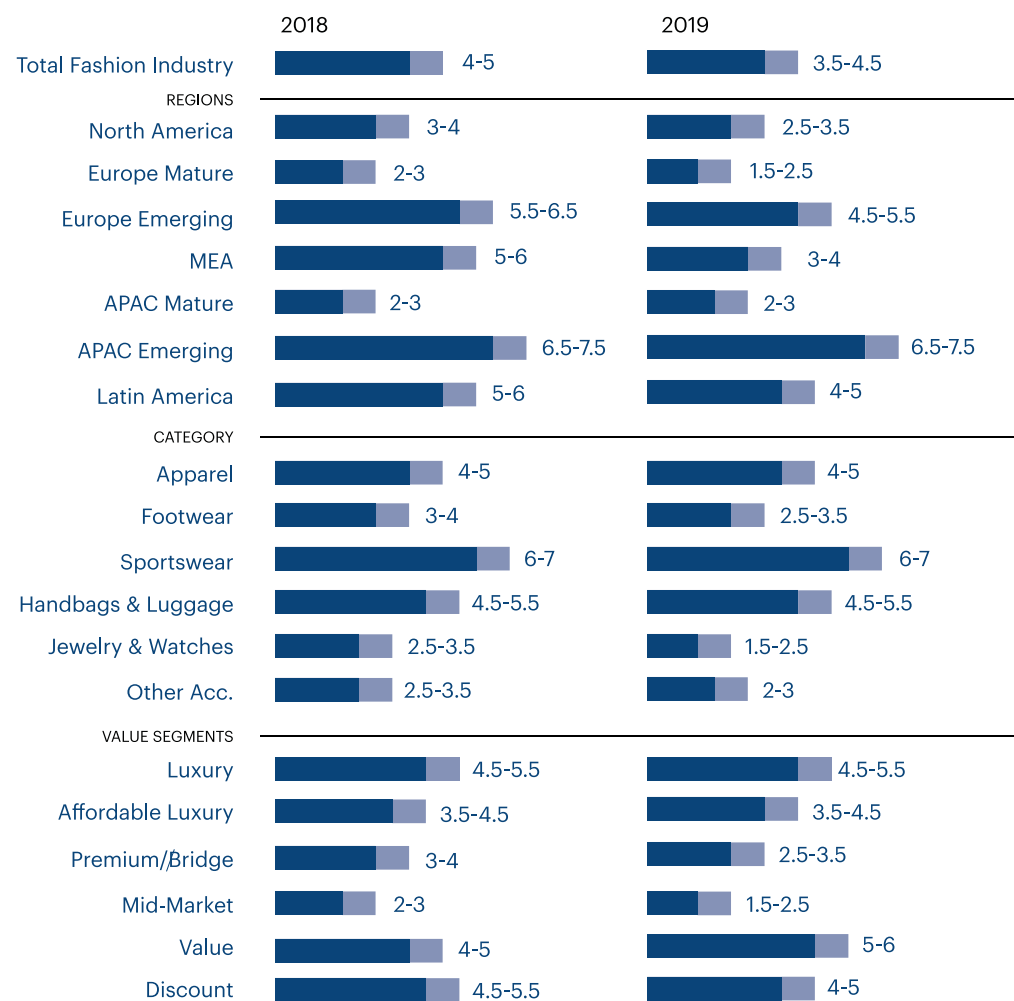
Product category performance. Similar to last year, we expect sportswear to continue its recent winning performance, boosted by strong demand from younger cohorts. Handbags and luggage are also likely to see strong growth, reflecting a global tourism boom that shows no sign of slowing. Jewellery and watches, on the other hand, may struggle in many markets as rental models start to replace traditional sales. In apparel, the rising sustainability movement may be a slowing factor in some markets, but the impact will probably be offset by growth in emerging markets.

Operating profit performance. We expect margins in aggregate to remain steady through 2019, despite caution among industry players. Some 67 percent of respondents in the BoF-McKinsey State of Fashion survey are concerned that margins will decline. Reasons cited include the broad-based move from offline to online channels, where margins tend to be thinner and distribution costs are higher, partly driven by high returns. Increased competition is also a factor, suggesting the need for rationalisation. Further, rising transparency may increase the pressure on prices, and there is limited room for further cost cutting following recent initiatives. On the other hand, there are several levers players are using to improve profitability, including efficiency drives, use of analytics to relieve markdown pressure and automation enabling faster speed to market.

At time of printing Brexit negotiations are still underway. Our forecasts assume that the UK and the EU will reach a deal enabling an orderly Brexit. While the fashion sector stands to be impacted under any scenario, failure to reach a deal (should it occur) could undermine growth prospects significantly in the short run. Current trade in finished fashion goods between the EU and the UK is worth \$23 billion (roughly 5 percent of the total European fashion market and 1.3 percent of the global fashion market). Including flows with all 67 countries with which the EU has trade deals, this number rises to \$28 billion (1.6 percent of the global fashion market).¹²⁵

Exhibit 21:
Fashion industry sales growth by region, category, and segment, 2018-2019

%



Source: McKinsey Global Fashion Index (MGFI)

Glossary

3D knitting

Manufacturing of a piece of clothing in one piece based on a digital design.

A/B testing

Experiments comparing two variants of a page and determining which performs better for achieving a given goal.

APAC (emerging):

American Samoa, Bangladesh, Bhutan, Brunei, Cambodia, China, Fiji, French Polynesia, Guam, Hong Kong, India, Indonesia, Kiribati, Laos, Macau, Malaysia, Mongolia, Myanmar, Nauru, Nepal, New Caledonia, North Korea, Papua New Guinea, Philippines, Samoa, Solomon Islands, Sri Lanka, Thailand, Tonga, Tuvalu, Vanuatu, Vietnam.

APAC (mature):

Australia, Hong Kong, Japan, New Zealand, Singapore, South Korea, Taiwan.

Application programming interface (API)

Communication protocols and tool for enabling access to various features or data of another service.

Artificial Intelligence (AI)

The theory and development of computer systems able to perform tasks that normally require human intelligence, such as visual perception, speech recognition, decision-making and translation between languages.

B-Corporations

For-profit companies certified by B-Lab, a global nonprofit, which requires them to meet various social, environmental, accounting and transparency standards.

Blockchain

A cryptographic or encoded ledger comprising a digital log of transactions shared across a network.

BoF-McKinsey State of Fashion Survey

Proprietary joint survey by the Business of Fashion and McKinsey. It asks international fashion executives and experts to rate their business sentiment, investment plans, and industry trends. 274 respondents participated in the State of Fashion Survey for the State of Fashion 2019 report between August and September 2018.

Challenger brands

Brands deploying a non-traditional go-to-market model (e.g., online direct to consumer, exclusively digital marketing) competing against established brands.

Chatbot

An AI-based computer programme that conducts auditory or text-based conversation.

Compound Annual Growth Rate (CAGR)

Annualised average rate of growth between two given years, assuming growth takes place at an exponentially compounded rate.

Costs of goods sold (COGS)

An income statement item stating the total costs used to create a product or service, which has been sold.

Customer decision journey

The journey of customer decision making, comprised of four primary phases: initial consideration; active evaluation, or the process of researching potential purchases; closure, when consumers buy brands; and post purchase, when consumers experience them.

Customer relationship management (CRM)

The strategy and processes for managing the company's relationships and interactions with existing and potential customers.

Earnings before interests and taxes (EBIT)

An income statement item that is calculated by deducting operating costs and the costs of running the business from total revenue. EBIT is the income a firm makes from its core operations.

Earnings before interests, tax, depreciation and amortisation (EBITDA)

An income statement item that deducts depreciation and amortisation from EBIT. An alternative measure of income a firm makes from its core operations.

Earned media value (EMV)

Media exposure gained through means other than paid advertising or owned media. Commonly used to measure influencer and social media marketing.

Economic profit

Measure for value add created by businesses, whereby opportunity costs are deducted from revenues earned. A company creates value when its operating profit exceeds the dollar cost of capital. Economic Profit is defined as Net Operating Profit, less Adjusted Taxes (NOPLAT) minus Capital Charge (WACC multiplied by Invested Capital).

Europe (Emerging)

Albania, Andorra, Armenia, Azerbaijan, Belarus, Bosnia-Herzegovina, Bulgaria, Croatia, Cyprus, Czech Republic, Estonia, Georgia, Hungary, Kosovo, Latvia, Lithuania, Macedonia, Moldova, Montenegro, Poland, Romania, Russia, Serbia, Slovakia, Slovenia, Turkey, Ukraine.

Europe (Mature)

Austria, Belgium, Denmark, Finland, France, Germany, Gibraltar, Greece, Iceland, Ireland, Italy, Liechtenstein, Luxembourg, Malta, Monaco, Netherlands, Norway, Portugal, Spain, Sweden, Switzerland, United Kingdom.

Foreign direct investment

An investment made by a firm or individual in one country into controlling interests of an entity in another country.

Full-price sell-through

The proportion of inventory that a retailer sells at the full (non-discounted) price to consumers.

Generation Z (Gen Z)

Demographic cohort born circa 1995–2014, following the millennial generation.

Gross Domestic Product (GDP)

Macroeconomic measure of the market value of all final goods and services produced in a country within a defined period.

International Monetary Fund (IMF)

A global organisation with a stated mission to “foster global monetary cooperation, secure financial stability, facilitate international trade, promote high employment and sustainable economic growth, and reduce poverty around the world.”

Initial public offering (IPO)

Very first sale of stock issued by a company on public markets.

Invested capital

The total amount of investments made by holders of both a company's debt and its equity.

Landed cost price

Cost of a garment sourced internationally including production, transportation fees, duties and other costs at the time of the arrival at the target port.

LatAm

Anguilla, Antigua, Argentina, Aruba, Bahamas, Barbados, Belize, Bermuda, Bolivia, Brazil, British Virgin Islands, Cayman Islands, Chile, Colombia, Costa Rica, Cuba, Curacao, Dominica, Dominican Republic, Ecuador, El Salvador, Grenada, Guadeloupe, Guatemala, Guyana, Haiti, Honduras, Jamaica, Martinique, Mexico, Nicaragua, Panama, Paraguay, Peru, Sint Maarten, Suriname, St Kitts, St Lucia, St Vincent and the Grenadines, Trinidad and Tobago, Uruguay, Venezuela.

Key performance indicator (KPI)

A quantifiable measure used to evaluate the success of an organisation in meeting objectives for performance.

Machine learning

A form of artificial intelligence that automates analytical model building, enabling systems to “learn” with minimal human intervention.

Made-to-measure

A clothing item specifically made to fit an individual.

McKinsey Global Fashion Index (MGFI)

Proprietary and copyrighted McKinsey tool that provides a global and holistic industry benchmark for the entire fashion industry. The MGFI was first created for The State of Fashion 2017 to track the industry performance through three key variables: sales, operating profit and economic profit. This year MGFI is composed of more than 500 public and private companies spanning across market segments, product categories and geographies. The analysis of public companies is built with data from McKinsey Corporate Performance Analytics.

MEA

Afghanistan, Algeria, Angola, Bahrain, Benin, Botswana, Burkina Faso, Burundi, Cameroon, Cape Verde, Central African Republic, Chad, Comoros, Congo, Democratic Republic of Congo, Djibouti, Egypt, Equatorial Guinea, Eritrea, Ethiopia, Gabon, Gambia, Ghana, Guinea, Guinea-Bissau, Iran, Iraq, Israel, Ivory Coast, Jordan, Kazakhstan, Kenya, Kuwait, Kyrgyzstan, Lebanon, Lesotho, Liberia, Libya, Madagascar, Malawi, Maldives, Mali, Mauritania, Mauritius, Morocco, Mozambique, Namibia, Niger, Nigeria, Oman, Pakistan, Qatar, Réunion, Rwanda, Sao Tomé e Príncipe, Saudi Arabia, Senegal, Seychelles, Sierra Leone, Somalia, South Africa, South Sudan, Sudan, Swaziland, Syria, Tajikistan, Tanzania, Togo, Tunisia, Turkmenistan, Uganda, United Arab Emirates, Uzbekistan, Yemen, Zambia, Zimbabwe.

Microfactory

Small, typically localised production designed to handle end-to-end fabrication, leveraging a variety of capabilities including 3D printing and welding. Microfactories are often used for prototyping and small batch production.

Millennials (Generation Y/Gen Y)

Demographic cohort born circa 1982–99. Are also commonly referred to as Generation Y (this name is based on Generation X, the generation that preceded them).

MSCI

Global stock market index of used as a common benchmark for the “global” stock market.

Nearshore

Sourcing markets that are near a base country, typically sharing a border. Advantages of nearshore markets include geographic proximity, shared time zones and cultural and political linkages.

NOPLAT

Net Operating Profit, less Adjusted Taxes (NOPLAT) is the value a company created through its core operations net of tax, if the company had no debt. It is calculated as EBIT multiplied by 1 minus the tax rate.

North America

Canada, Puerto Rico, United States of America.

Organisation for Economic Co-operation and Development (OECD)

An intergovernmental economic organisation with the stated mission to “promote policies that will improve the economic and social well-being of people around the world.”

Omnichannel

Sales approach that provides the customer with an integrated shopping experience across a multitude of online and offline sales channels.

Platform-as-a-service

Capabilities extend from container orchestration, code management and continuous deployment, to highly sophisticated machine learning platforms that commoditise much of what is cutting-edge.

Price segments in MGFI

As definitions of market segments often vary across sources, all companies in the MGFI are categorised based on a Sales Price Index, providing a range of prices for a standard basket of products within each segment and home market – thereby relying only on a quantitative measure, whereby companies in each segment price their items similarly.

Public cloud

Computing services offered by third-party providers over the public internet, making them available to anyone who wants to use or purchase them.

Pull based supply chain

Supply chain constructed to be responsive to customer demands. Products enter the supply chain only when customer demands justify it.

Push based supply chain

Supply chain based on forward looking projections of customer demands. Productions levels are predetermined and “pushed” to the market.

Selling, general and administrative expenses (SG&A)

An income statement item stating all costs not directly tied to making a product or service.

Shoppability

Ease of turning a desire into a purchase from a consumer's perspective.

Software-as-a-service

Software distribution model in which a third-party provider hosts applications and makes them available to customers over the Internet.

South-South trade

Trade between developing economies, also known as countries of the Global South.

S&P 500

American stock market index consisting of 500 largest companies by market capitalisation.

Telemetry

An automated process of collecting information from remote points and transmitting to a receiving hub.

Unorganised retail (India)

Retail sector consisting of private commercial enterprises not registered with the government; typically self-employed individuals.

User experience (UX)

Overall experience, including emotions, perceptions, and reactions, to the usage of a product or service. UX design refers to the optimisation of the experience.

User interface (UI)

The intersection where an information devices and users interact. Most common examples include interactive aspects of operating systems and interfaces of digital applications.

Value segments

Segmentation of the fashion markets and participating companies used in the McKinsey Global Fashion Index and the BoF-McKinsey State of Fashion Survey. The companies are categorised in 6 segments, which are based on a price index across a wide basket of goods and geographies. The segments comprise from lowest to highest price segment: Discount, Value, Mid-market, Premium/Bridge, Affordable Luxury, Luxury.

Visual search

Search tool designed to yield information based on a visual based input, such as a photograph.

Weighted Average Cost of Capital (WACC)

Calculation of a firms cost of capital in which each category of capital (debt and equity) is proportionately weighted. It is the minimum return that the holders of a company's debt and equity expect given the risks associated with investing in the company.

White label

A product or service, sold from a company to a reseller, that is rebranded and packaged to appear as proprietary to the reseller.

“Woke”

A phrase defined as “alert to injustice in society,” popularised on social media and often associated with the Black Lives Matter movement.

World Input Output Database (WIOD)

To assess how the textiles and apparel value chain is changing in our article “Global Value Chains in Apparel: The New China Effect”, we use the 2016 release of the World Input Output Database (WIOD), which we extended back to 1995 and forward to 2017.

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Infographics

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1. Caution ahead

Source: BoF-McKinsey State of Fashion Survey, The Business of Fashion and McKinsey & Company, September 2018

2. Indian ascent

Source: “Global Smartphone User Penetration Forecast by 88 Countries: 2007 – 2022”, Strategy Analytics, 2017

3. Trade 2.0

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4. End of ownership

Source: BoF-McKinsey State of Fashion Survey, The Business of Fashion and McKinsey & Company, September 2018

5. Getting woke

Source: EDI’TED analysis in partnership with McKinsey & Company, September 2018

6. Now or Never

Source: “The urban delivery bet: USD 5 billion in venture capital at risk?”, McKinsey & Company, May 2017

7. Radical transparency

Source: BoF-McKinsey State of Fashion Survey, The Business of Fashion and McKinsey & Company, September 2018

8. Self disrupt

Source: BoF-McKinsey State of Fashion 2018 Survey, The Business of Fashion and McKinsey & Company, 2018

9. Digital landgrab

Source: McKinsey Global Fashion Index 2018 based on McKinsey Corporate Performance Analytics data, McKinsey & Company, 2018

10. On demand

Source: Andersson, Johanna, Achim Berg, Saskia Hedrich and Karl-Hendrik Magnus et al., “Is apparel manufacturing coming home?”, McKinsey & Company, October 2018, <https://www.mckinsey.com/industries/retail/our-insights/is-apparel-manufacturing-coming-home>

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Source: Smit, Sven, “Economic Conditions Snapshot, September 2018: McKinsey Global Survey results”, McKinsey & Company, September 2018, <https://www.mckinsey.com/business-functions/strategy-and-corporate-finance/our-insights/economic-conditions-snapshot-september-2018-mckinsey-global-survey-results>

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Source: McKinsey & Company analysis based on Economist Intelligence Unit CountryData, <https://store.eiu.com/product/countrydata>

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Source: Smit, Sven, “Economic Conditions Snapshot, September 2018: McKinsey Global Survey results”, McKinsey & Company, September 2018, <https://www.mckinsey.com/business-functions/strategy-and-corporate-finance/our-insights/economic-conditions-snapshot-september-2018-mckinsey-global-survey-results>

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Source: McKinsey Global Fashion Index 2018 based on McKinsey Corporate Performance Analytics data, McKinsey & Company, 2018

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Source: Andersson, Johanna, Achim Berg, Saskia Hedrich and Karl-Hendrik Magnus et al., “Is apparel manufacturing coming home?”, McKinsey & Company, October 2018, <https://www.mckinsey.com/industries/retail/our-insights/is-apparel-manufacturing-coming-home>

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Source: Interviews with experts; McKinsey & Company

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