

The State of Fashion

2017



The State of Fashion 2017



A world that is uncertain, changing,
and challenging by **Craig & Karl**

The State of Fashion 2017 was created to provide a comprehensive view of the fashion industry—one whose coverage remains fragmented and not systematically reported. Its principal aim is to lay out the interconnectedness of the entire fashion ecosystem across market segments and product categories by distilling the industry's current and projected performance, and addressing the factors shaping and driving fashion today and in the year to come.

To accomplish this, the report relies on extensive qualitative and quantitative analyses, drawing on industry and proprietary sources, including executive interviews, the new BoF-McKinsey Global Fashion Survey, the McKinsey Global Fashion Index, which tracks industry sales, operating profit, and economic profit (value creation) and McKinsey's FashionScope, a city-level growth forecasting tool for the fashion industry.

The report is split into two sections: Section 1 provides a review of the industry in 2016, highlighting the industry's performance across sales, operating profit (EBITA), and economic profit—a measure of value-add that takes into account both the explicit and implicit costs of generating income—and recapping the ten key themes that shaped 2016; Section 2 provides an outlook for 2017, forecasting for the first time expected growth for the fashion industry across market segments and product categories, highlighting the top priorities for executives, and defining the ten trends that we believe will set the agenda for the industry over the next 12 months.

In order to present a full picture of the ecosystem and bring to life the complex and multifaceted aspects of the industry, the report also includes a series of deep dives and executive interviews on some of the most exciting developments, including the growth of Russia's fashion market, the new wave of digitisation of the supply chain, and the rise of new consumer capitals in China, the Middle East, and Latin America.

BoF McKinsey&Company

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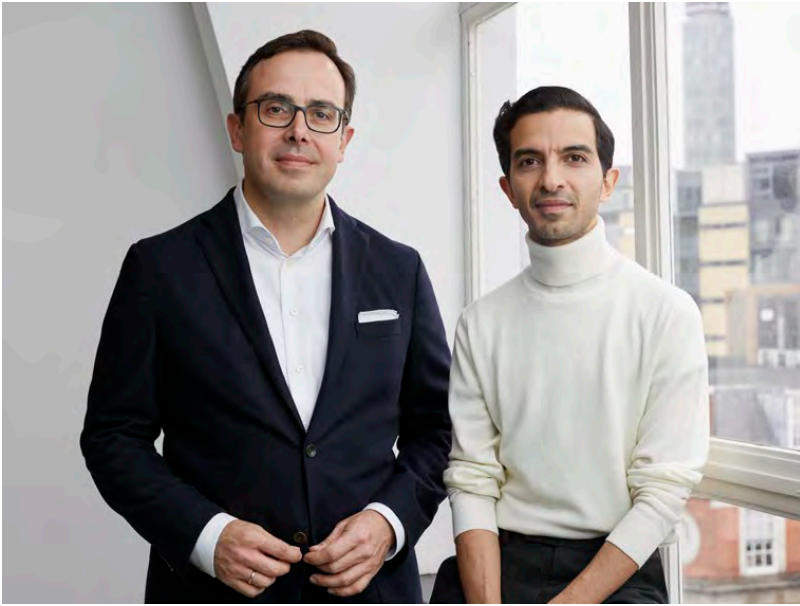
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FOREWORD



Fashion is one of the world's most important industries, driving a significant part of the global economy. In 2016, the industry is projected to reach a staggering \$2.4 trillion in total value.¹ If it were ranked alongside individual countries' GDP, the global fashion industry would represent the world's seventh largest economy.²

And yet, for some observers, fashion is still regarded as simultaneously frivolous and indulgent; and many of the sources of information about the industry are fragmented, incomplete, or unreliable.

Now, McKinsey & Company and The Business of Fashion (BoF) are aiming to close that gap. Our first State of Fashion report lays the foundation for rigorous in-depth research and analysis of the global fashion industry, focusing on the themes, issues, and opportunities impacting the sector and its performance.

Over the last few months we have put together a global network of experts, research and analysis from to bring you a report that makes sense of the challenges and opportunities across all of fashion's market segments – from mass global discount retailers to exclusive luxury brands – as well as specific product categories and geographies.

Thomas Lehr

Our aim is threefold: first, to establish a common understanding of the forces that are shaping the industry the most; second, to shed some clarity and transparency on the industry's performance; and third, to look ahead and set the agenda for the topics that should be top of mind for business and creative leaders in 2017, to form the basis of the discussions and conversations we are having at VOICES, BoF's new annual gathering for big thinkers taking place from December 1-3, 2016.

By bringing together our two organisations, we have pooled resources to draw on BoF's industry expertise and insider access alongside McKinsey's functional, analytical and industry insight to offer a rare blend of quantitative rigour and sharp-eyed qualitative insights about the fashion sector.

To inform our analysis, we surveyed senior industry executives from around the world and conducted in-depth interviews with some of the most influential and forward-thinking people in the industry. Our collective knowledge creation is unique and an integral part of this report, and the insights we share will be relevant to everyone who engages in the business of fashion, whether in the boardroom, as an entrepreneur building a start-up, or even as an informed shopper on the high street.

With this report, we also unveil a new industry benchmark: the McKinsey Global Fashion Index (MGFI). With a database of over 450 different fashion companies, this index will allow for analysis and comparison of how a fashion company is performing against others in its market segment, product category, and even operating model. Over time, the data set will grow and become ever more valuable as a source of insight into both the pressures impacting fashion, as well as the opportunities and new sources of revenue and innovation that will emerge from the world's increasingly turbulent fashion markets.

For creative leaders and business executives, this has arguably been the most uncertain operating environment in living memory. However, we hope that with new resources like The State of Fashion and the McKinsey Global Fashion Index, the global fashion community will be in a stronger position to face challenges in the market, and plot a path to a successful future.

IMRAN AMED and ACHIM BERG

CONTRIBUTORS

IMRAN AMED



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 three-million-strong community from over 200 countries and territories. Previously, he was a consultant at McKinsey in London.

SASKIA HEDRICH



As well as working with apparel clients globally on strategy, sourcing optimisation, merchandising transformation, and CSR, Saskia supports countries in Africa, Asia, and Latin America to develop strategies for their national garment industries. As senior expert, Saskia is a regular speaker and author of industry publications.

ACHIM BERG



Based in Frankfurt, Achim Berg co-leads McKinsey's Global Apparel, Fashion & Luxury Practice and is active in all relevant sectors including clothing, textiles, footwear, athletic wear, accessories, and retailers spanning from the value end to luxury. As a global fashion industry and retail expert, he supports clients on a broad range of strategic and top management topics, as well as on operations and sourcing-related issues.

JOHNATTAN LEON



Johnattan brings his experience as a former associate at The Business of Fashion to his work serving McKinsey's Apparel, Fashion & Luxury clients across categories and functional topics—from jewellery and fashion media to digital transformations, strategy, and marketing and sales.

LEONIE BRANTBERG



As the head of McKinsey's fashion work in the United Kingdom, Leonie has led the turnarounds of several iconic European fashion brands, working across a range of topics in strategy, customer experience, inventory management, and digital/omnichannel. Leonie is a regular speaker and author of industry publications on multiple aspects of fashion and luxury goods.

ROBB YOUNG



As global markets editor of The Business of Fashion, Robb oversees content from Asia-Pacific, the Middle East, Latin America, Africa, the CIS, and Eastern Europe. He is an expert on emerging and frontier markets, whose career as a fashion editor, business journalist, author, and strategic consultant has seen him lead industry projects around the world.

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“Terrorist attacks in France, the Brexit vote in the UK, and the volatility of the Chinese stock market have created shocks to the global economy. Meanwhile, consumers have become more demanding, more discerning, and less predictable.”

EXECUTIVE SUMMARY

Looking back at 2016 — one of the toughest years on record

As fashion executives around the world reported to us in the first BoF-McKinsey Global Fashion Survey, 2016 can be summarised in three words: uncertain, changing, and challenging.

Indeed, this has been one of the toughest years ever for the global fashion industry. Terrorist attacks in France, the Brexit vote in the UK, and the volatility of the Chinese stock market have created shocks to the global economy, which has not been this volatile since the depths of the financial crisis of 2009. Meanwhile, consumers have become more demanding, more discerning, and less predictable in their purchasing behaviour, which is being radically reshaped by new technologies.

But the shockwaves have not only been external. Fashion companies have also been looking inward, implementing changes to their core operations—from shortening the length of the fashion cycle to integrating sustainable inno-

vation into their core product design and manufacturing processes—re-evaluating the entire fashion system itself.

Perhaps unsurprisingly then, 67 percent of the executives surveyed reported that conditions for the fashion industry have worsened over the past 12 months, a fact that is clearly borne out in the industry’s financial performance this year. Sales growth is on track to slow to just 2–3 percent by the end of 2016, with stagnating profit margins. Speculation and uncertainty over the impact of the outcome of the election in the United States could further impact sales if consumer sentiment dampens. This is in stark contrast to the fashion industry’s performance over the previous decade, which saw the industry grow at 5.5 percent annually according to the McKinsey Global Fashion Index, outpacing overall GDP growth.³

It is important to note that industry performance in 2016 has not been even across all market segments and categories. This year

was particularly difficult for the luxury and mid-market players, who were hit by the slowdown in China and the US and are expected to grow at rates below the industry average at 0.5-1% and 2-2.5%, respectively. One category that is experiencing significant deceleration is watches and jewellery. While it was the fastest growing category between 2005 and 2015 – having enjoyed a compounded growth rate of 11% according to the MGFI – watches and jewellery is expected to grow just 1.5-2% this year. The luxury end of the category suffered an especially hard blow.

But in spite of these and other challenging circumstances, fashion remains one of the key value-creating industries for the world economy. If it were ranked alongside individual countries' GDP the global fashion industry would represent the seventh-largest economy in the world.⁴ Moreover, 2016 also saw many exciting changes: the advance of digital, the launch of “see-now, buy-now”, and a thorough creative shake-up at fashion houses.

Outlook for 2017: Glimmers of recovery

In 2017 we expect the fashion industry to see the glimmers of a rebound.

This recovery has several foundations. First macroeconomic indicators, including GDP growth forecasts, are projected at 3.4 percent compared with 3.1 for 2016, however these have not been adjusted to reflect the ongoing impact of important political shifts in the United States and the United Kingdom.

Second, the investment community and the fashion brands themselves forecast improvement across the industry next year. Some 40 percent of executives we interviewed for this report expect conditions for the fashion industry to improve in 2017, compared with the 19 percent who reported improving conditions in 2016. This is particu-

larly true for the major players within each of the market segments and product categories.⁶ Many of them have already undertaken significant cost-cutting and restructuring exercises, and are now primed to capture the benefits. All things considered, we fashion industry growth could increase from 2–2.5 percent in 2016 to 2.5–3.5 percent in 2017, although the days when the industry outpaced GDP growth by more than 1–2 percentage points, as it has done over the past decade, seem to be over.

Performance will vary according to the individual dynamics of specific market segments and categories. Value and affordable luxury are likely to be the big winners, both outpacing the industry average at a projected 3.0-4.0 percent and 3.5–4.5 percent growth, respectively; however, all of the market segments—except for the discount market—should see a slight sales growth improvement of 0.5–1.5 percentage points.

Product categories are expected to grow in line with the overall industry average, but the biggest winners will be those companies with coherent channel strategies and clear value propositions. Athletic wear is positioned to be the absolute category winner, maintaining 6.5–7.5 percent sales growth, albeit no longer growing at a double-digit rate overall. The affordable luxury segment seems likely to continue benefitting from consumers “trading down” from luxury, while signs point to the continued growth of the value segment in line with the international expansion of large global players.

In short, the industry now has the opportunity to stabilise and reset. Next year's success stories are most likely to come from those that are already planning for the year ahead. They should do this in the context of the following trends that we believe will shape the fashion industry in 2017.

10 TRENDS THAT WILL DEFINE THE FASHION AGENDA IN 2017

1. INTENSIFYING VOLATILITY

Volatility is the new normal. Geopolitical instability, terrorism, Brexit, and stalled trade deals will all increase a pervasive sense of uncertainty in the global economy.

2. CHINA'S COMEBACK?

China's fundamentals, including growth of the middle and upper classes, remain strong and the government's new fiscal policies are expected to improve conditions in 2017, but uncertainty remains.

3. URBAN ENGINES

City-based strategies trump country-based strategies: a new class of rapidly growing wealthy cities in newly influential markets are becoming central to the evolution of fashion.

4. SHREWDER SHOPPERS

Working harder to keep up with smarter shoppers: “always-on” consumers are becoming ever more sophisticated, more technology-driven, and harder to predict.

5. GENERATION CORRELATION

Opportunities to serve the young and the old better: fashion companies should consider how to fine-tune and diversify the way they approach both retired and millennials consumers.

6. THE WELLNESS DIVIDEND

Feeling good is the new looking good: more fashion players can start profiting from the wellness movement rather than competing with it.

7. CHANGING THE RHYTHM

Disruptions to the fashion cycle: expectations set by the faster pace of fashion and consumer desire for instant gratification must be addressed to deliver fashion immediacy.

8. ORGANIC GROWTH

Investing more to nurture local clientele: 2017 has the potential to be the year of organic growth based on deeper relationships with existing clients rather than geographic, channel, and store network expansion.

9. UPSTREAM TECHNOLOGY

Digital innovation goes behind the scenes: digitisation is a key to supply-chain efficiency, lower procurement costs, and enhanced sourcing opportunities.

10. OWNERSHIP SHAKE-UP

Emotionless reappraisal of brand portfolios: fashion conglomerates can be expected to further intensify their focus on big brands, creating space for other brands and industry outsiders such as private equity and family owners to acquire targets.

I. INDUSTRY REVIEW 2016



“Across all market segments, product categories, and geographies, the industry has been shocked by tremors in the global macroeconomic and geopolitical sphere, largescale shifts in consumer behaviour, and intensifying business pressures to produce more for less—less time, less money, and less effort.”

2016 INDUSTRY PERFORMANCE

Exhibit 1 The top 3 words executives used to describe the fashion industry in 2016

Uncertain
Changing
Challenging

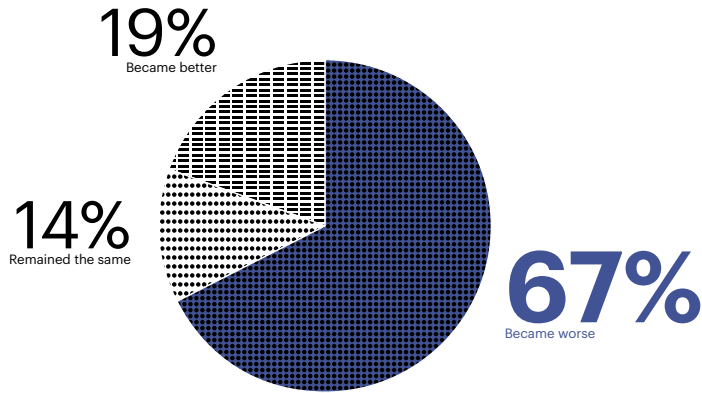
Source BoF-McKinsey Global Fashion Survey, September 2016

This has been one of the hardest years the fashion industry has ever experienced. Across all market segments, product categories, and geographies, the industry has been shocked by tremors in the global macroeconomic and geopolitical sphere, large-scale shifts in consumer behaviour, and intensifying business pressures to produce more for less—less time, less money, and less effort.

Indeed, the prevailing business sentiment amongst fashion industry insiders reflects the challenges of managing in this complex environment. According to the BoF-McKinsey Global Fashion Survey, 67 percent of respondents—a mix of top fashion executives, creatives, investors, and other industry insiders—believe that conditions for the fashion industry have become worse over the past 12 months (Exhibit 2). Not only are they overwhelmingly pessimistic about the year’s performance, but the top three words they selected to describe the industry today are: uncertain, changing, and challenging (Exhibit 1).

Exhibit 2 67% of survey respondents believe that conditions for the fashion industry have become worse over the past 12 months

Fashion business sentiment 2016
% of respondents



Question Over the past 12 months, how do you think conditions for the fashion industry have changed?
Source BoF-McKinsey Global Fashion Survey, September 2016

This is in part due to the wide range of challenges the industry has faced in 2016. Top of the list of survey respondents' worries were volatile shifts in the global economy, followed by competition from online players and decreasing foot traffic, and the speed of changing consumer preferences (Exhibit 3). In addition, businesses were concerned about both their top and bottom lines, with margin erosion from increased discounting and a general slowdown of sales growth this year. The last group of concerns centred on the increased speed to market and changes in the fashion cycle seen in 2016.

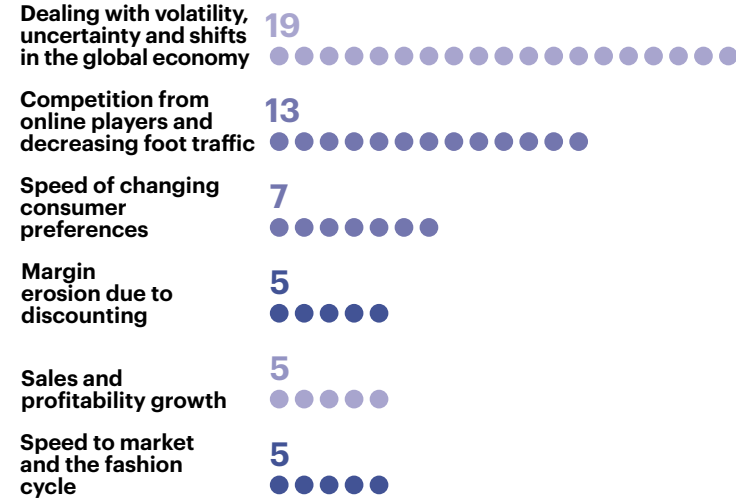
All this notwithstanding, the industry remained positive about growth opportunities, highlighting digitisation and e-commerce as by far the single biggest opportunity of 2016. Interestingly, while some businesses saw increased speed to market as an industry challenge, others saw "see-now, buy-now" as an excellent new opportunity. Finally all market shifts result in winners and losers—and those smart enough to master this time of unprecedented change have the best chance to emerge as winners in the coming year.

Exhibit 3 Executives name volatility and uncertainty as the biggest challenge, and see digitalisation and e-commerce as the biggest opportunity of the year

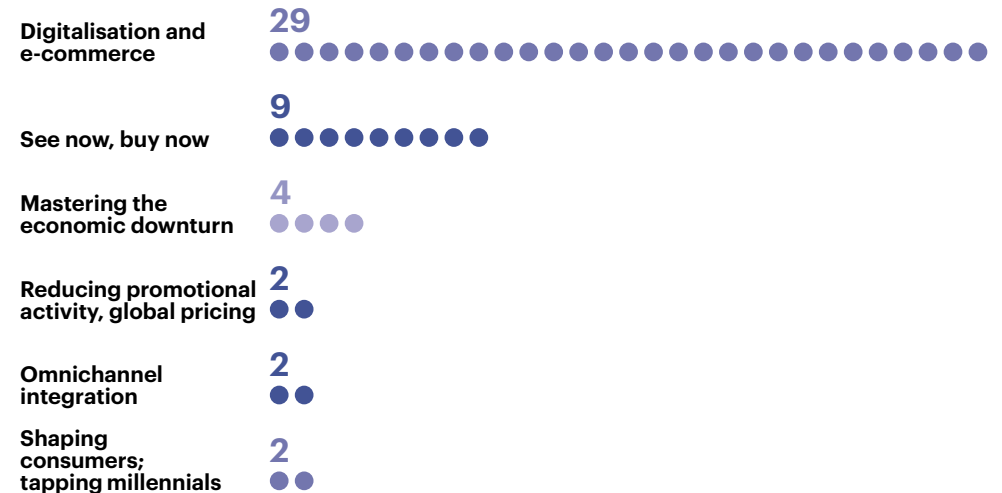
% of executives

● Global economy ● Consumer ● Fashion system

TOP 6 CHALLENGES



TOP 6 OPPORTUNITIES



Question What do you think has been the single biggest challenge and the single biggest opportunity for the fashion industry in 2016 so far?
Source BoF-McKinsey Global Fashion Survey, September 2016

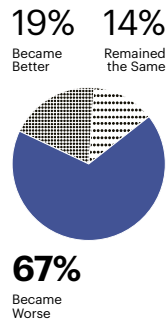
2016 YEAR IN REVIEW: FASHION INDUSTRY TRENDS

GLOBAL ECONOMY

Age of uncertainty

01.

Geopolitical and economic instability intensifies, raising concerns about the impact of destabilising forces such as terrorism, growing volatility and uncertainty on the fashion industry

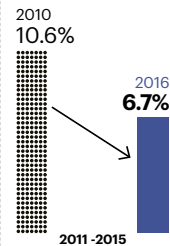


67% of executives believe that economy will worsen in 2016

China interrupted

02.

Chinese growth hits a soft patch: a stock market dip and real estate concerns have decelerated chinese growth, and shifted attention to India, Turkey, and other high-growth markets



Chinese GDP continues to slow-down in 2016

CONSUMER SHIFTS

Discount culture

03.

Promotions and discounts are the new normal: Consumers have come to expect frequent discounts and promotions, buying less and less at full-price

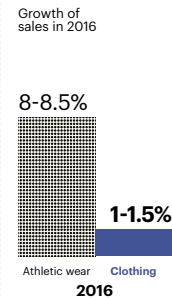


Number of full-price stores in the US and Canada lower than discount stores.

Consumer kinship

04.

New customer lifestyles come into focus: Emerging consumer tribes are driven by casualisation, inclusivity and active lifestyles, giving rise to athleisure, genderless, plus-size and modest wear fashion

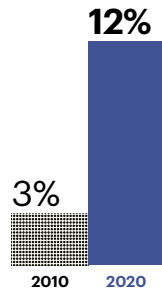


More people wearing casual clothes - Growth of sales of sport-inspired apparel 5x higher than of general Clothing in 2016

Digital upgrade

05.

The fashion industry gets more proficient with the digital realm: Digital platforms and strategies become more prevalent, integrated and sophisticated, with e-commerce rising, pure-play brands emerging, and brands engaging with consumers through virtual reality



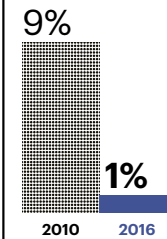
E-commerce luxury fashion sales will increase fourfold from 2010 to 2020

THE FASHION SYSTEM

System breakdown

06.

Fashion's fragile system hits a breakdown: The fashion industry faced a year marked by a low sales growth, price volatility and overstocking

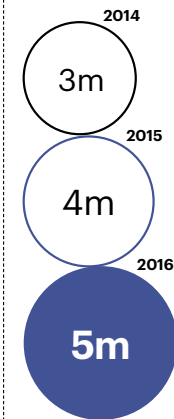


Sales growth lower today than 5 years ago - e.g. Clothing y-o-y growth: 1-2% in 2016 vs. 8% in 2011

Cost cutting

07.

It's getting harder to reduce costs: Sourcing won't solve the cost problem any longer; more companies are turning to restructuring, job cuts, and even store closures.



Google results "fashion restructuring"

Throughout the year, major fashion companies announced programmes to reduce headcount, close stores, and review their processes

Instant gratification

08.

"See-now, buy-now" adds to channel pressures: New cycle models are promising immediate consumer gratification, from off-the-runway fashion to instant delivery



Lead time reduction from 6 months to 0. Lead time from catwalk to shopping bag eliminated

A creativity crisis

09.

The accelerated pace of fashion industry cycles prompts a creativity crisis: More collections and shorter design cycles are leading to high turnover among creative directors, and putting strains on the creative process



~30 high-profile creative director rotations

Responsible innovation

10.

Ethical innovation offers a way forward: Consumers and brands have prioritised sustainable fashion, which is transforming product design and manufacturing



More than 65% of emerging market consumers actively seek sustainable fashion versus 32% or less in mature markets

GLOBAL ECONOMY

“Fashion purchases are often emotional ones, and if consumers are feeling uncertain or scared, they are less likely to buy. Many fashion players are working to develop the agility they need to respond to short-term changes, such as abrupt drops in demand that occur when consumers stay away.”

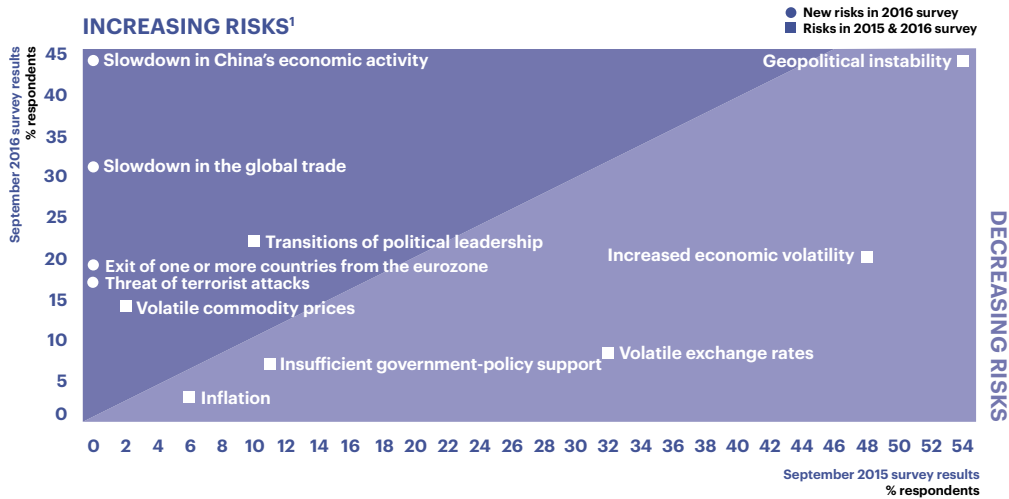
01. Age of uncertainty

Global disruptions caused by political conflicts, terrorism, and financial crises have made the world more volatile and uncertain. Only one thing is certain: instability is here to stay. According to McKinsey's Global Executive Survey⁷ among over 1,600 global CEOs, concerns about the threat of terrorist attacks, the slowdown of China's economic activity, geopolitical instability, and the exit of one or more countries from the Eurozone have increased over the past year (Exhibit 4). Terrorism provides an example of how instability can affect the entire



Justin Tallis/
Getty Images

Exhibit 4 44% of global executives believe geopolitical instability and the slowdown in China economy are the highest risk to economic growth



1 The risk matrix represent the % of respondents that voted for a particular risk. The area above the dividing line indicates decreasing risk while the area below indicates increasing risk in September 2016 vs. September 2015.

Question What risks to economic growth will be present in the global economy over the next 12 months?
 Source McKinsey's Global Economics Intelligence Quarterly Executive Survey, September 2015 & 2016

value chain for the fashion industry. Not only have sourcing regions suffered from attacks in the past, but fears of terrorist activity can keep shoppers out of certain areas or discourage tourists from visiting destinations that depend on them as consumers. For much of the year, the outcome and impact of the recent US election was the main topic of speculation.

As a fast-moving, globally connected industry, fashion is uniquely exposed to this dynamic.

Fashion purchases are often emotional ones, and if consumers are feeling uncertain or scared, they are less likely to buy. Many fashion players are working to develop the agility they need to respond to short-term changes, such as abrupt drops in demand that occur when consumers stay away.

Volatility takes many forms. Currency has been more volatile in 2016 than it was on average for the past five years. Meanwhile, a study from the McKinsey Global Institute (MGI) shows

global debt has risen faster than GDP.⁸ Many factors are continuing to amplify these trends. For example, the world is increasingly interconnected: by 2020 MGI expects some 940 million online shoppers to spend almost \$1 trillion on cross-border e-commerce transactions. Industrialisation and urbanisation in emerging economies, aging populations in established markets, and new technologies further complicate the current environment.

Fashion faces all these challenges and more—including the partial commoditisation of the fashion market, faster fashion cycles, and compliance and sustainability issues. Demand can fluctuate widely, while shocks to the cost base, such as the impact of plummeting exchange rates on sourcing costs, are a constant threat. As a result, the value created by apparel and luxury companies varies much more than it does for the market overall.

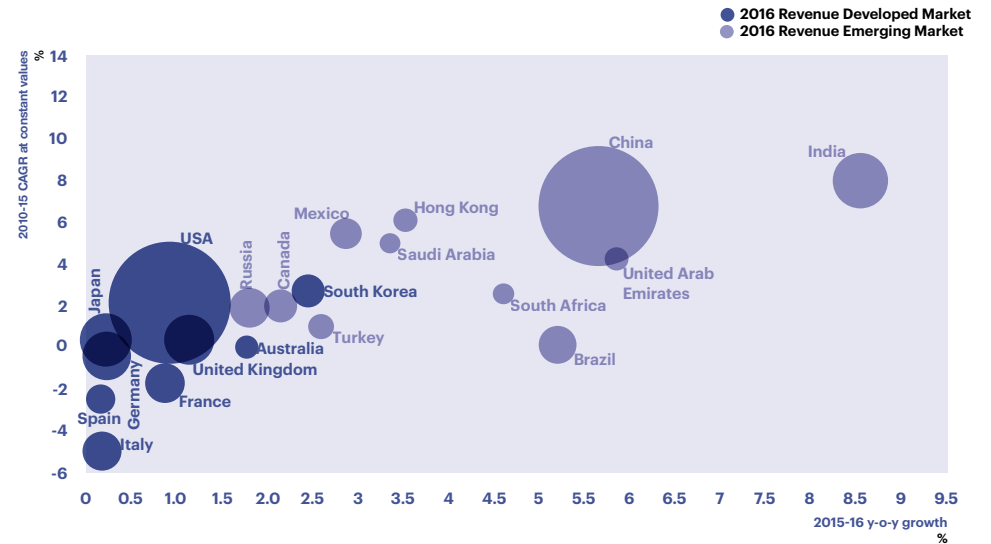
02. China interrupted

As highlighted by the BoF-McKinsey Global Fashion Survey, a key topic of discussion over the past year has been the economic slowdown in China, which has been one of the key growth markets for fashion since the 2008 financial crisis. Chinese GDP growth has slowed to 6.7 percent this year, from 7.0 percent in 2015 and 10.0 percent in 2010. While this slowdown is not severe Western standards, it is notable all the same given the absolute size of this market. What makes 2016 noteworthy is the combination of the CSI 300 Index turbulence early in 2016, and the over-supply of apartment buildings and other real-estate issues that have emerged to cloud the investment outlook in China. Moreover, according to McKinsey's 2016 China Consumer report,⁹ which surveyed 10,000 Chinese consumers, shopping patterns are changing fast: Chinese consumers are becoming more selective about their spending, allocating more of their income to lifestyle

services and experiences, and trading up from mass products to premium products.

While China remains a large and important market, these headwinds are decreasing sales growth and therefore shifting the spotlight to other emerging markets, where consumers are still improving living standards at a higher pace. FashionScope's projected growth this year compared with annual growth for the past five years shows that the highest-growth countries are expected to be India and the United Arab Emirates but lag far behind in size compared to China and the United States (Exhibit 5). The size of the fashion industry in some of these countries is smaller, but there are still interesting opportunities for growth, particularly compared with other emerging countries where foreign-exchange fluctuations and economic slowdowns have taken their toll on consumer spending, such as Brazil and Russia.

Exhibit 5 Growing at 9% in 2016, India leads emerging markets as the fastest growing country for fashion



1 Excludes Argentina and Venezuela due to poor data reliability resulting from FX fluctuations.

Source McKinsey FashionScope

CONSUMER SHIFTS

SALE
SALE
SALE

03. Discount culture

In 2016, the consumer landscape for fashion also saw significant shifts. Naturally, the increased economic and geopolitical uncertainty led to a decline in consumer and fashion spend across the board. Not only are consumers demanding more customised and personalised fashion, but they are also increasingly expecting it at lower prices. In particular, the North American market continues to be characterised by its high share of off-price sales. So far in 2016, off-price shoppers account for 75 percent of apparel purchases across all channels, and some traditional retailers now have more outlet stores and discount stores than full-price shops.¹⁰ This focus on promotions and discounts is, moreover, becoming increasingly prevalent in other markets, such as China—where outlet malls are booming, and set to double in number by 2020¹¹—and in Europe, where, for example, there are now six mark-down periods scheduled across the year in the United Kingdom.¹² Similar trends are playing out in Germany and other EU countries. While such tactics are useful to drive footfall in the short-term, they are generally unhealthy for fashion companies, as mark-downs and promotions eventually lead to a “race to the bottom” that shrinks profit margins and eats away at brand value.

04. Consumer kinship

Consumer lifestyles also continued to evolve, and this year saw a marked rise in fashion companies responding to these lifestyles with tailored offers and collections. In particular, four fashion categories surged in 2016 in response to new or growing consumer lifestyles. First, athletic wear has grown significantly in response to consumers’ push for casualization, having grown at 10 percent over the past ten years, according to the McKinsey Global Fashion Index, while apparel and footwear overall were growing at 4 percent. Second, genderless fashion collections have emerged for those unwilling to conform to the traditional male- or female-only clothing staples. Zara launched their first “genderless” collection in March this year, following earlier moves by the likes of Selfridges to reconfigure its gender departments the year before.¹³ Third, the focus on plus-size fashion is at an all-time high, with the number of mentions of “plus-size” in the fashion press so far in 2016 tripling versus last year.¹⁴ Fashion brands are rapidly responding to a cultural shift towards body positivity and a growing appreciation of curvy figures, by designing specifically for a larger

range of sizes rather than just expanding their size range as an afterthought. Fourth, modest wear has also gained in prominence in the past year, highlighting the unique needs and growing importance of devout Islamic consumers, especially from the Middle East and South East Asia; this has been particularly led by brands such as Uniqlo and Dolce & Gabbana which unveiled hijab and abaya collections in Europe at the beginning of this year.¹⁵ According to the Global Islamic Economy report, the modest-wear market alone is forecast to be worth \$327 billion by 2020.¹⁶ Not only are mainstream brands becoming more aware of this opportunity but the market itself is expanding.

Taken as a whole, these markets may well create sizeable new opportunities for mid-market and luxury players. More importantly they all highlight an overarching consumer lifestyle need for personalisation and customisation. Brands have started to respond to that in innovative ways, leveraging consumer data to offer digital personalised shopping services at a mass-market level—something that just a few years ago was exclusively the preserve of high-end luxury players.



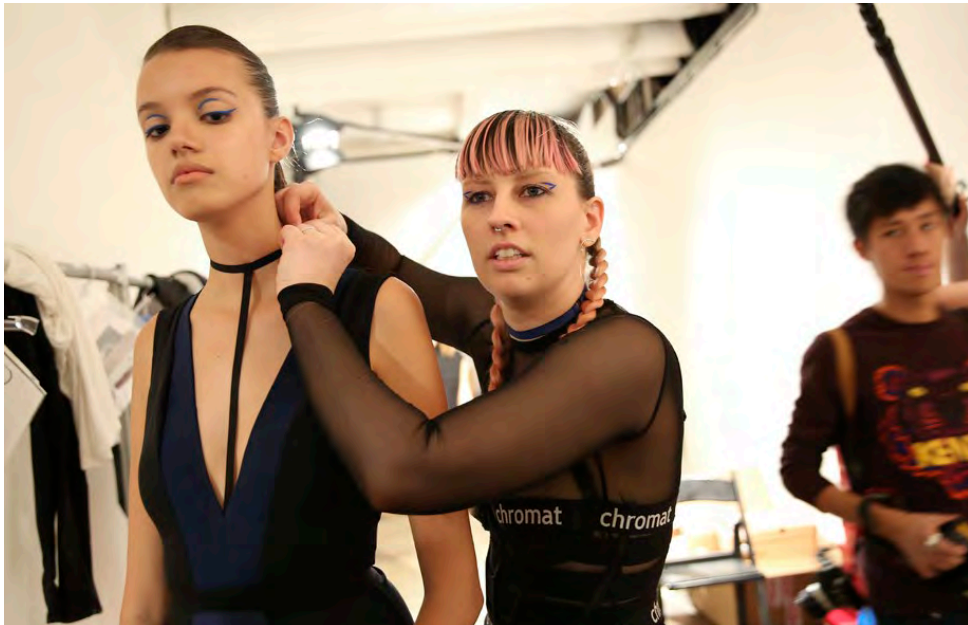
Dolce & Gabbana Abaya Autumn/Winter 2016
Courtesy

05. Digital upgrades

Part of the reason why consumers have been able to seek discounts and promotions has been their uptake on e-commerce and digital tools, which has created price transparency across brands and regions. Over the past few years, consumers have grown more comfortable with digital interactions and buying online. While online sales are growing at a steady pace—even in luxury from 3 percent of sales in 2010 to 12 percent of sales in 2020¹⁷—one of the challenges fashion companies face is striking the right balance between online and in-store assortments and, of course, pricing. In 2016, digital platforms and strategies became more prevalent, integrated, and sophisticated. One such example is Amazon.com, which has decided to enter the fashion business as a strategic choice, given its existing competencies. In February it launched seven of its own pure-play brands sold exclusively on its site.¹⁸ This adds further pressure to store-based retailing, which continues to ebb away, slipping

particularly badly in the department store category.¹⁹

While e-shopping is certainly quickening the competitive metabolism of the fashion industry, 2016 saw a surge in the innovative use of digital tools to engage with consumers in a new way, and drive sales. For instance, virtual reality (VR) headsets are introducing the industry to the immersive world of three-dimensional fashion shows. During the September 2016 New York Fashion Week, 13 shows in all were broadcast in 360-degree VR, including collections from Prabal Gurung, Rebecca Minkoff, and Erin Fetherstone.²⁰ Dior and Tommy Hilfiger are just two of the brands using VR in stores to transport headset-clad shoppers to prerecorded catwalk shows.²¹ While VR is currently a novelty, many industry insiders believe it holds immense promise as a new medium for immersive storytelling in future.



Chromat Autumn/Winter 2016 fashion show
Monica Schipper/Getty Images

THE FASHION SYSTEM

06. System slowdown

Because of today's volatile global economy and an increasingly demanding consumers, significant pressures are being introduced to an inherently fragile fashion system. Since the financial crisis of 2008 and 2009, industry sales have slowed across every significant category, from clothing and footwear, to bags and luggage, watches and jewellery. As shown by McKinsey's Global Fashion Index projections for 2016, there are early signs some of these categories are staging a mild recovery (Exhibit 12).

Increasing price and demand volatility have also complicated the picture. In comparison with the price index of consumer goods, the price index for apparel fluctuates more strongly across countries throughout the year as brands adjust to demand.²² Inevitably, that uncertainty in demand places more inventory at risk. In the first half of this year, for example, the US retail industry's inventory-to-sales ratio hit a new high since 2009.²³ This is not the healthiest metric for US retailers, so this point bears close monitoring.

07. Cost burdens

In order to maintain margins in the wake of slow sales, companies look at restructuring as a measure to reduce costs; however, over the past year, many factors—from exchange rate fluctuations and labour costs to the cost of raw materials—have raised sourcing costs.²⁴ Indeed, cost-control measures, whether sourcing from emerging low-labour-cost countries or more efficient manufacturing techniques, have largely been exhausted. For instance, according to the Cotlook A Index, the average price of cotton has ticked higher in 2016 than in the past two years (Exhibit 6), and continues to increase. While the traditional answer has been to diversify sourcing as one way of keeping costs low, today there are only so many options for production. Many fashion companies across the spectrum, from Burberry, Sonia Rykiel, Roberto Cavalli to Ralph Lauren and Marks & Spencer, have undertaken restructurings and job cuts, even shuttering stores and reviewing their store networks, all in an effort to make ends meet.²⁵ But the cost pressures persist.

08. Instant gratification

A more demanding consumer and a bid by fashion brands to create additional demand has also forced an increase in the speed of delivery of products across fashion's market segments. Running counter to cost-reduction measures, fashion companies are attempting to increase sales by responding more rapidly to consumer demand. Though the rapid lifecycle of mass-market collections in the fast-fashion category is well known, it is now reaching the luxury and affordable luxury segments, putting additional pressure on supply chains and distribution management in 2016. This shows no sign of abating: whether feeding instant gratification or building out delivery channels, brands have pushed boldly into the digital era where customers globally have virtual access to fashion shows and buy collections at the click of a button. Some luxury brands, led by Burberry, Tom Ford, and Tommy Hilfiger, have experimented with the “see-now, buy-now” approach, extending it all the way to the runways of September's fashion shows.²⁶ Others—both luxury and mass-market brands—are experimenting with same-day, or in specific markets, even one-hour delivery.²⁷ The jury is still out on whether these new approaches will win over the most demanding customers while also maintaining margins and profitability over the longer term.



Burberry Spring/Summer 2017
Image: Courtesy Burberry

Exhibit 6 Cotton prices have risen throughout 2016, reaching a 2-year high of \$0.86/pound in August

Cotlook 'A' Index
USD per pound



Source Cotlook

09. A creativity crisis

Experimenting with fashion cycles is not new. The pace of fashion has accelerated greatly in recent years, with many brands increasing the number of collections—now averaging six per year—and ratcheting down the lead times for pieces, even at the luxury end of the spectrum. Now, however, this combined with other pressures has led to an unprecedented level of turnover among creative directors for several major luxury and fashion brands, with designer exits and arrivals at Christian Dior, Lanvin, Calvin Klein, Saint Laurent, Ermenegildo Zegna, Berluti, Balenciaga, Oscar de la Renta, Brioni, and Carven, amongst others.²⁸

At the same time, the reduced time between cycles has led to an increase in alleged plagiarism,

as the pressure to create new collections is as much a concern for mass-market players as it is for luxury brands.²⁹ Even fast-fashion companies are adjusting their processes to accommodate even shorter design cycles.

Another form of pressure bearing down on creativity comes from the way new designs are sanctioned for production. Fashion designers are being encouraged to take more input from the buying and merchandising teams to react to what is selling rather than defining what will sell through forward-looking design risks.³⁰

How the various pressures on fashion players will reach equilibrium remains, for now, an open question.

10. Responsible Innovation

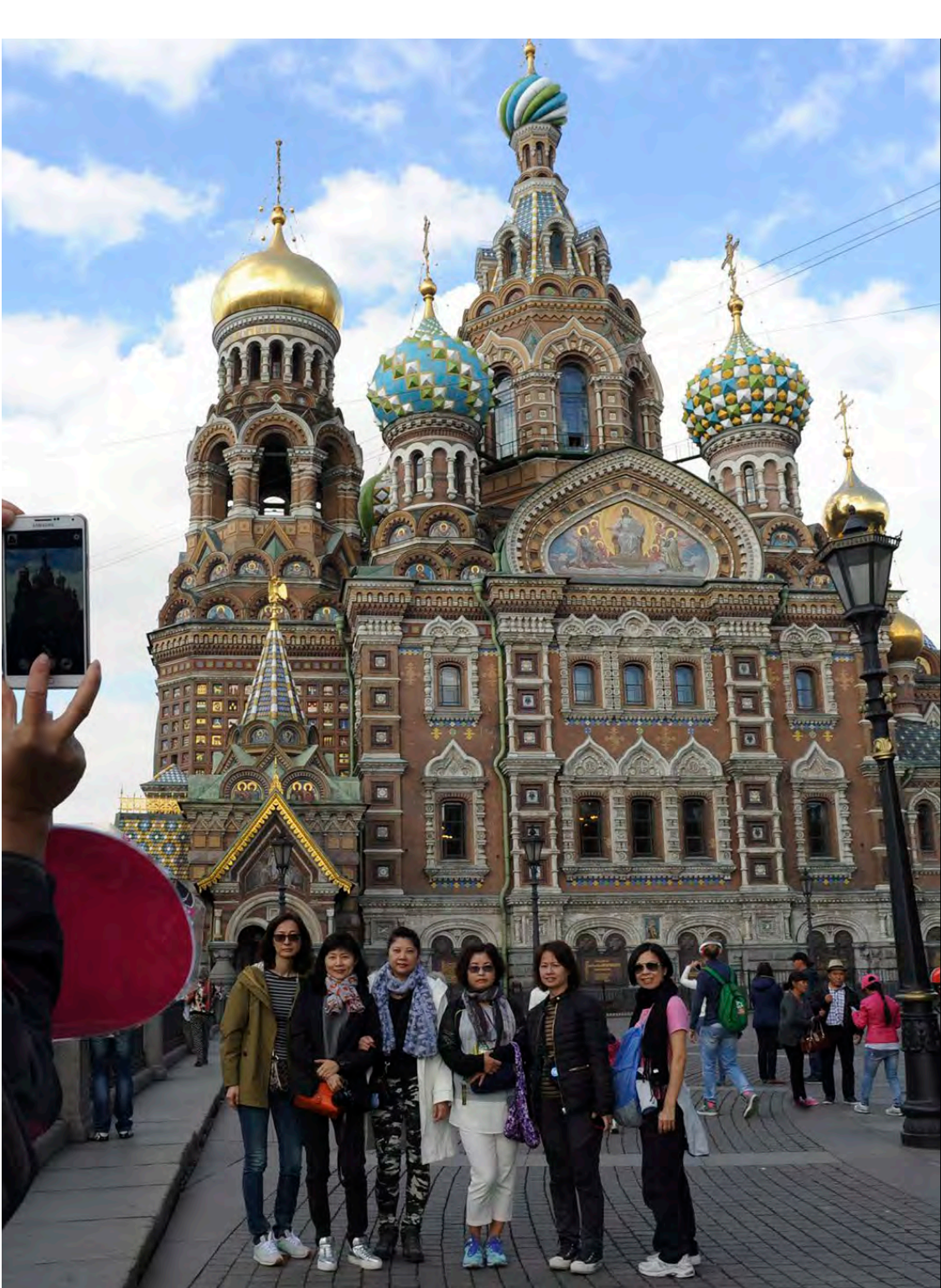
Finally, if 2016 was a year of opposing forces clashing, the push for sustainability was one common thread across the industry. Sustainability is becoming an important new driver of consumers' purchasing decisions. In emerging markets, for example, more than 65 percent of consumers actively seek out sustainable fashion.³¹ Global population growth, climate change, land and water scarcity, and the increasing cost of key resources have a direct impact on the bottom line of every company. The speed of fast fashion amplifies these issues and magnifies five fundamental problems for the fashion industry: high water consumption, discharge of hazardous chemicals, violation of human rights, labor standards, greenhouse-gas emissions, and waste production. For fashion companies, responding to these issues has become an area of potential differentiation and creative inspiration underscored by the theme for the 2016 Copenhagen Fashion Summit, "Responsible Innovation".³²

A number of cross-industry initiatives has highlighted the potential for identifying more sustainable ways to work across a product's whole lifecycle. For several years now some of the largest fashion companies, such as H&M and Nike, have publicly set sustainability goals, and established

awards to promote collaboration and set standards for closed-loop fabric imports and other forms of material innovation.³³ This year, Nike unveiled its European Logistics campus in Belgium, founded on responding to sustainability challenges and maximising performance while minimising footprint.³⁴ This is an area that offers real benefits for fashion brands, whether mass-market or luxury, as all companies are under pressure to increase transparency on inputs and reveal more of the pedigree of their products.



Copenhagen Fashion Summit 2016
Image: Courtesy Danish Fashion Institute



HOW RED TOURISM BEAT THE RUSSIAN RECESSION

Tsum's general director Alexander Pavlov explains how 'red tourism' from China and quick-response pricing strategies helped boost sales at the Russian department store by 40 percent.

by Limei Hoang and Robb Young

MOSCOW, Russia — For Alexander Pavlov, the decision to dramatically cut prices at Russia's famed luxury department store was a risk worth taking. Though it was at a time when local customers were tightening their belts, Tsum's general director saw an opportunity where others did not.

Over the last few years, Russia has witnessed a new kind of tourist hoping to take advantage of the weak rouble — one of the world's worst-performing currencies over the 2014-15 period.³⁵ The Russian economy has been suffering due to a combination of factors including low oil prices and international sanctions resulting from geopolitical tensions with the West.

"After barely avoiding a recession in 2014 — with 0.7 percent growth — the economy contracted by 3.7 percent in 2015," says Alex Sukharevsky, a Moscow-based senior partner at McKinsey & Company. "The recession continues into 2016, but it is expected to be limited to 1-2 percent with forecasts improving as oil prices rebound. Most analysts expect a return to modest growth in 2017 at around 1 percent."

Official data released in August 2016 by Rosstat, Russia's statistics service, showed that Russians' real disposable incomes had fallen at the fastest pace in seven years.³⁶ Many Russian consumers have been struggling to maintain the lifestyles to which they became accustomed in the boom years.

"Consumer confidence experienced a double-dip decline in 2014-16, although the drop has been more modest than during the 2009 crisis. Overall retail sales

were down 10 percent in 2015 and keep decreasing in 2016," Sukharevsky adds.

Yet one silver lining in the country's otherwise dim market environment is that Russia has emerged as a more affordable place for foreigners to shop. Typically, Russian retailers are at a disadvantage because of euro-denominated designer fashion and heavy import duties. This can amount to luxury goods being 20 to 30 percent more expensive than the same items at retailers in France or Italy, depending on product category.³⁷

However, by the middle of 2016, the rouble was trading at half the value it was to the dollar two years earlier.³⁸ For affluent shoppers willing to travel from abroad, unlikely though it seemed, Russia suddenly had the potential of a bargain hunter's paradise.

If they were fast and bold enough in their approach, Russian retailers could now finally offer globally competitive prices to help compensate for the shortfall in domestic spend. Pavlov wasted no time adjusting Tsum's prices down to make the department store even more attractive to international customers hungry for anything from Armani to Zegna.

After slashing the prices of handbags, Pavlov says the company soon tripled sales of its accessories business which led him to cut prices on shoes and finally on ready-to-wear. The risk he took to lure in foreign shoppers by discounting paid off, he says, resulting in an estimated 40 percent year-on-year sales increase for Tsum between 2015 and 2016.

What makes Tsum's 2016 business illuminating is

not only its role in helping to make Russia an unexpected international shopping destination. It is the fact that many of those who Pavlov attracted were from China.

“After we lowered our prices, we started advertising inside airports and airplanes and we connected later with them on social networks so we were able to increase sales with the Chinese by five-fold,” says Pavlov.

“For Asian tourists in particular, it is often easier to come to Moscow rather than travel to Europe,” he adds, referring to the shorter flight time from cities in China to Moscow compared to destinations in Western Europe.

The Chinese spent around \$1 billion just in Russia in 2015 and 60 percent of it was on shopping, according to various estimates.³⁹ Rosstat’s data reveals that the number of Chinese tourists increased 65 percent year-on-year from 2014 to 2015. It counted 677,619 of them in 2015, but this figure does not include Chinese visitors coming for business or other purposes besides tourism. Therefore the total number of Chinese visitors to Russia was actually twice as high.

The positive trajectory continued in the first half of 2016. In fact, a Federal Agency for Tourism tally of all inbound tourists to Russia revealed something interesting. While the total number of foreign visitors was down 5 percent year-on-year, Chinese visitors were up 9 percent, earning them the rank of fifth highest out of all nationalities visiting Russia.

The Rise of ‘Red Tourism’

The Chinese view Russia as an exotic yet familiar enough destination, a place where tourists are emboldened by the weak rouble, visa-free group travel and a growing nostalgia for visiting communist sites beyond those in China.

A peak in so-called ‘red tourism’ has made sites such as Karl Marx’s house in Germany and Vladimir Lenin’s birthplace in Russia popular among a certain profile and generation of Chinese travellers. Cuba is also expected to profit from this phenomenon now that Air China opened a flight from Beijing to Havana.⁴⁰

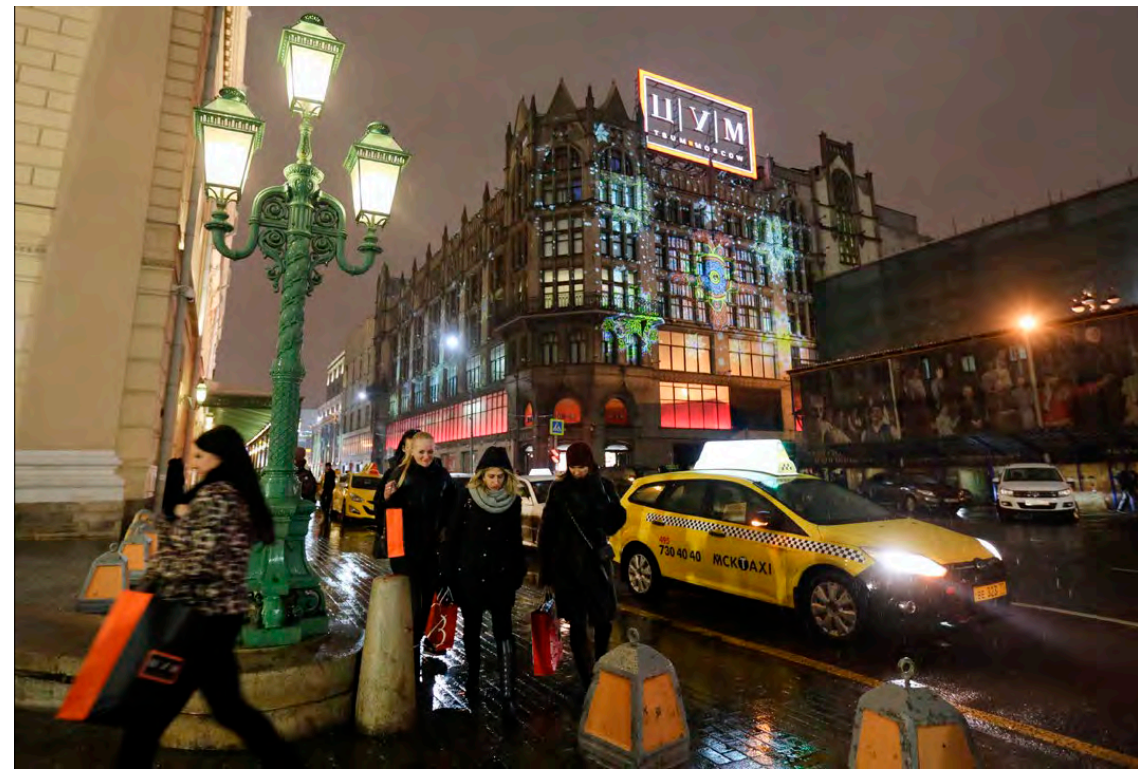
But Russia, as the successor state to the Soviet Union, is by far the destination with the greatest diversity of perceived landmarks and memorabilia outside China itself.⁴¹ The backdrop of an historic alliance between the two countries certainly helps.

In 2015, the neighbours signed a \$25 billion deal to boost flagging trade and Chinese lending to Russian companies. As part of an agreement to deepen economic cooperation between the two, they also decided to open more ‘red tourism’ routes in the future.

Growing Chinese tourism is one way Tsum hopes to continue to defy the downturn in Russia’s economy. Pavlov says he expects the number of tourists to increase by 3 to 5 times in 2017 and he hopes to convert as many of them as he can to become Tsum shoppers.

However, critics consider this revenue stream precarious at best, as it is predicated on a continually weak rouble against other major currencies that make up the currency basket behind the Chinese yuan. Nevertheless, Pavlov nevertheless remains optimistic.

“After we lowered our prices, we started advertising inside airports and airplanes and we connected later with them on social networks so we were able to increase sales with the Chinese by five-fold.”



Tsum Store in Moscow
Bloomberg / Getty Images

He aims to grow the number of Chinese customers to 30 percent in the next two to three years, from the current 9 percent that Chinese account for in terms of overall sales at Tsum’s Moscow flagship. At its sister department store DLT in St Petersburg, which like Tsum is part of Russia’s largest luxury retail group Mercury, the number is even greater. There, the Chinese account for 22 percent of overall sales, he says.

“We want to increase awareness in China and make Chinese customers know that Russia is the best place to travel and shop in Europe,” Pavlov says. “We’re very China-friendly. We have Chinese navigation in both department stores, department store guides in Chinese, Chinese speaking staff, special offers for our foreign customers, and we’ll keep on improving our loyalty programme for them too.”

The company is working closely with Russian and Chinese tour operators, as well as the Russian tourism board to promote its stores to Chinese tourists.

“Tsum is definitely taking advantage of the trend,” says Christian Kwok, art director at Vogue Russia, who has noted the increase in Chinese visitors. “They have already put up signs in Chinese indicating that tourists

are welcome to purchase goods with a similar price to Milan and Paris, and even a Chinese sign in the parking lot. There was only Russian and English before.”

The company is also offering a special discount to overseas tourists, Kwok observes, to perhaps make up for the current lack of a duty-free shopping regime in Russia — though there are reports that the country may introduce one in 2017.

Another draw for some Chinese is the perception of security in Russia. Moscow is increasingly considered to be a safe option compared to cities in Western Europe, says Kwok, noting that past terror attacks in France and Belgium remain a concern for many Chinese travellers.

It is important to note that Russia still attracts comparatively few Chinese shoppers when seen in the context of those travelling to retail hotspots in Europe, South Korea, Hong Kong and Japan.

However, Pavlov stresses that even in relatively small numbers, the Chinese have already been a welcome relief for luxury fashion players like Tsum operating in a sector that is clearly struggling in Russia. And he remains as enthusiastic about their potential in the coming years as he does about his plan to attract more through his doors.

McKinsey Global Fashion Index

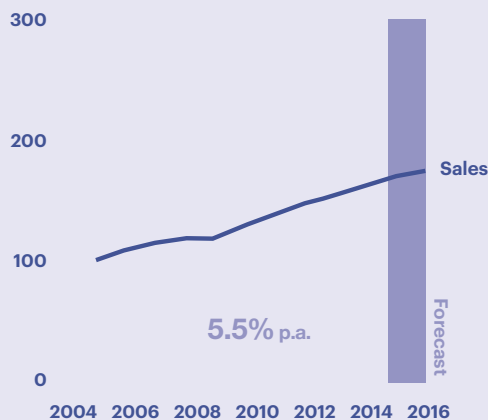
The McKinsey Global Fashion Index (MGFI) is composed of more than 450 public and private companies spanning across market segments, product categories, and geographies, created to track the industry's performance through three key variables - sales, operating profit, and economic profit - going back to 2005.

The fashion industry is one of the largest and most value-creating industries in the world—above media, transportation, and even commercial and professional services—yet its performance tracking remains largely fragmented and is not reported systematically across market segments, product categories, operating models, or regions. Although not directly comparable, if the fashion industry were a country, its market size would equate the seventh-largest GDP in the world⁴², before the likes of India and Italy. The McKinsey Global Fashion Index (MGFI) was developed to fill the gap in understanding around this ecosystem and provide a global and holistic benchmark for the entire fashion industry—from luxury to discount players. The index is composed of more than 450 public and private companies, representing almost 50 percent of the global market in terms of its size; the companies included are a representative sample of companies across market segments, product category focus, geography, operating model, and sales.

Whereas other industry performance indices focus on particular segments, product categories,

Exhibit 7 McKinsey Global Fashion Index predicts the fashion industry will grow 2-2.5% in 2016; the lowest level since the financial crisis

Total fashion
Dec 2005 = 100



Sales: Reported sales (nominal, net of excise duty) at constant 2015 exchange rates

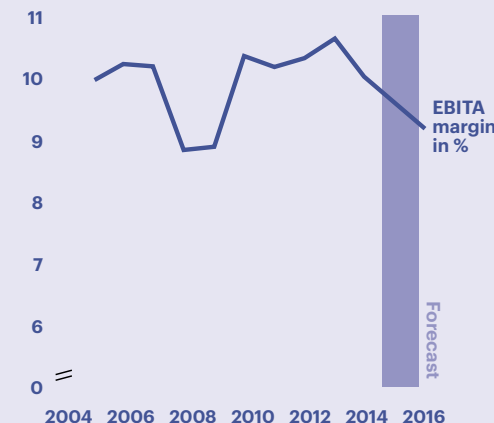
Source McKinsey Global Fashion Index 2016

ries, or the top or bottom line of mainly public companies, MGFI looks at the entire industry. Obtaining a clear picture of the industry as a whole is important because all the segments are interconnected, and consumers shop across the whole range, so when one part of the ecosystem changes this will affect all the other parts. MGFI tracks three key performance variables—sales, operating profit, and economic profit—going back to 2005 (Exhibits 7-9). In addition to the top and bottom line, the index also tracks economic profit (s. glossary) as a measure of value creation to determine how much each company had to invest to generate its performance. These variables are further broken down for six price segments: luxury, affordable luxury, premium/bridge, mid-market, value, and discount. The index covers six product categories: clothing, footwear, athletic wear, bags and luggage, watches and jewellery, and other accessories. All of these categories have different dynamics across different markets so granularity is vital.

Given the number of opinions and sources with varying definitions on market segments, each

Exhibit 8 The industry's operating profit has levelled since 2013 and we expect margins to decline further by -0.5-0 percentage points in 2016

Total fashion
Dec 2005 = 100



EBITA: Operating profit measure - Earnings Before Interest, Taxes, and Amortization

Source McKinsey Global Fashion Index 2016

Exhibit 9 Despite slowing sales growth and declining profit margins, MGFI shows that economic profit in the industry has doubled since 2009

Total fashion
Dec 2005 = 100



Economic Profit: Measure for value-add, whereby opportunity costs (incl. invested capital) are deducted from revenues earned

Source McKinsey Global Fashion Index 2016

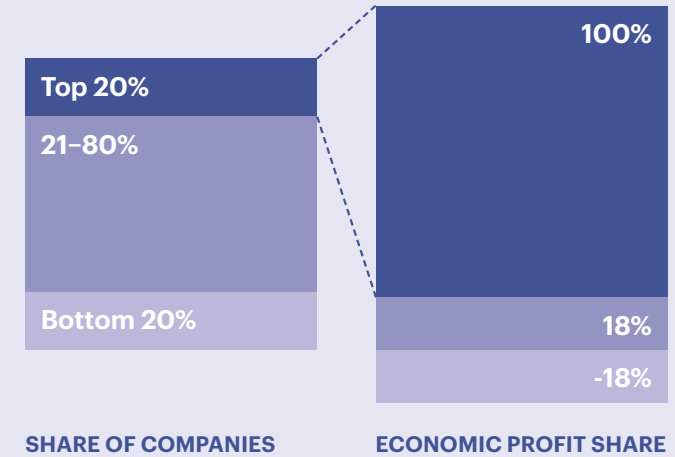
Exhibit 10 Throughout the report, we refer to 6 fashion market segments, which have been created using a price index across a wide basket of goods and geographies

PRICE	SEGMENTS	BRAND EXAMPLES	BASKET EXAMPLE Men's jeans ¹
High	Luxury	Tom Ford Chanel	>\$315
	Affordable luxury	Tory Burch Michael Kors	\$156-\$315
	Premium / Bridge	Nike Esprit	\$96-\$155
	Mid-Market	Zara Topshop	\$41-\$95
	Value	TJ Maxx boohoo.com	\$21-\$40
	Discount	Primark George at Asda	<\$20
Low			

¹ Plain men's straight/slim cut jeans (no rips). Exemplary 1 out of 9 total items used in basket calculation

Source McKinsey & The Business of Fashion team analysis

Exhibit 11 Over the past decade, the top 20% of fashion companies created 100% of the economic profit for the industry



Source McKinsey Global Fashion Index 2016

company in the MGFI is categorised based on a Sales Price Index. The Sales Price Index provides a range of prices for a standard basket of products within each segment and company's home market (Exhibit 10). By contrast with other definitions of market segments, the MGFI relies only on a quantitative measure, whereby companies in each segment price their items similarly.

Through the McKinsey Global Fashion Index, brands and investors alike will be able to track industry performance and in a variety of situations, including:

- Tracking performance against peer companies by segment, value, and operating model
- Identifying which business areas will be most promising
- Identifying the levers that have been the most successfully used to create value or increase profits

Despite the wider economic slowdown in 2016, fashion has been a key value-creating industry for the world economy. Over the past ten years economic profit has outpaced sales growth, growing at 8 percent per year. This has been driven both by margin increases, and by increased capital efficiency. Nonetheless, most of the industry value is captured by a small percentage of players, with the top 20 percent creating 100 percent of total economic profit and the bottom 20 percent contributing an economic loss of 18 percent (Exhibit 11). Among the top 20 percent are: Adidas, Burberry, Chow Tai Fook, Richemont, Fast Retailing, Hermès, H&M, Inditex, L Brands, Luxottica, LVMH, M&S, Michael Kors, Next, Nike, Nordstrom, Pandora, Prada, Ralph Lauren and TJX. Fashion is essentially a winner-takes-all industry—a handful of companies that make the right decisions and execute flawlessly are the ones that reap the lion's share of the rewards.

Overall industry performance

The business sentiment captured above is also borne out by the actual outcomes we expect in 2016. After years of stable growth rates, the industry is expected to face a major slowdown in 2016, dipping from 5.0 percent growth in 2015 to 2.0–2.5 percent growth in 2016 (Exhibit 12). As the McKinsey Global Fashion Index shows, this is the slowest growth fashion has seen in the past decade, a period during which the industry has consistently outperaced global GDP growth, having recorded 5.5 percent between 2005 and 2015 (Exhibit 7). The 2016 slowdown has affected all market segments and product categories across the board. Nonetheless, fashion is still outperforming global GDP growth⁴³ at 2.0–2.5 percent though not at its historical excess of one to two percentage points. The negative impact on sales across all segments is the result of a volatile global environment, reduced tourism, and the economic slowdown in China. Speculation and uncertainty over the impact of the outcome of the election in the United States could further impact the critical holiday shopping season if consumer sentiment dampens.

In line with slowing sales growth, there has also been no margin improvement: the amount by which revenues exceed costs is down by up to 0.5 percentage points. Over the past three years, profitability growth has tailed off in spite of continued sales growth, expected to deliver a profit margin of only 9.0–9.5 percent in 2016. This is the result of wider sales growth slowdown, rising costs, and also lower pricing power by fashion companies, due to increased competition, price transparency and rampant discounting.

The lack of significant differences in performance of product categories for the most part suggests that the main driver of sales and profit is the positioning of each brand and the value proposition it communicates to consumers.

Market segment performance

In terms of market segments, the biggest winners in 2016 have been affordable luxury and value, which have outperformed all of the other segments by 1.0–1.5 percentage points (Exhibit 9). This is consistent with their growth over the past three

years, which has seen a 6 percent compound annual growth rate (CAGR) for value and 9 percent for affordable luxury, the highest rate for any of the segments since 2013.

Affordable luxury players benefited from consumers trading down from luxury, particularly amongst Chinese consumers. In North America especially, the affordable luxury segment's growth was driven by new players operating with the positioning of designer quality at affordable prices. However, their profit margins are expected to continue to decline, especially after 2016, due to a pricing arbitrage disadvantage across geographies and fluctuating foreign exchange rates.

The value segment also continued to grow in 2016, particularly as a consequence of large global players expanding geographically. As indicated by the MGFI, the only segments that have seen sales and profit margins increase are discount and value players, which have increased their economic profit over the past five years and created significant value for the industry. With its clearly defined value proposition, the value segment has been taking share from discount this year. Moreover, supermarkets and hypermarkets selling items at discount prices are also suffering, with many of these closing this year; accordingly this has led to mixed results and a neutral projection for this segment.

The biggest losers, however, have been the luxury and mid-market segments. Hit by challenges in the past decade's most-bankable growth markets, such as China and the United States, growth in the luxury segment is expected to slow to 0.5–1.0 percent this year versus the 8.0 percent CAGR recorded between 2010 and 2015. In 2016, the struggle of the mid-market segment seems unlikely to end. According to the MGFI, over the past five years this has been the slowest-growing segment at 5.0 percent CAGR, with a sharp drop in operating profit margins of 4.0 percent. Given the high spread between the best and worst-performing companies, it's clear that many of these players are not communicating a clear value proposition to consumers. This year, growth should be moderate and driven by large established companies, and particularly e-commerce players.

Product category performance

In 2016, athletic wear is projected to grow at 8.0–8.5 percent—more than twice as fast as any other category. This is consistent with its 10 percent CAGR of the past decade, driven by consumers' more active lifestyles, the rise of "athleisure", emerging brands in the high-end segments, and product innovations. As athletic wear continues to grow, it will become a category with the ability to compete on equal terms with clothing and footwear, particularly in the mid-market and premium segments. In line with the general slowdown of the luxury segment, subdued growth of just 1.0–1.5 percent is expected for clothing and footwear.

Over the past decade, bags and luggage have been a consistently impressive source of growth, at rates often as high as 10.0 percent. This growth

is slowing rapidly: in 2016, it is forecast to be down to 3.5–4.0 percent. This development is due to former luxury consumers trading down to cheaper options, which puts pressure on profit margins.

Similarly, although watches and jewellery are expected to maintain a constant growth of 1.5–2.0 percent in 2016, this is a slowdown from the previous decade. According to MGFI, compounded annual sales growth here between 2005 and 2015 was the highest of any category at 11.0 percent. The largest impact is due to the shift on luxury spending, particularly for watches. Watches have suffered especially from reduced gifting in China, decreased tourism over the past year, and competing wearable technology gadgets. The same is true for higher-end jewellery, so actual growth in this category will come from mass offerings.

Exhibit 12 We expect fashion industry growth will slow to 2-2.5% in 2016 – slowest in Luxury at 0.5-1%, fastest in Athletic wear at 8-8.5%

GLOBAL FASHION SALES GROWTH 2015-2016

	FASHION INDUSTRY GROWTH	2015-16
GLOBAL	Total industry	2–2½ %
SEGMENT	Luxury	½–1 %
	Affordable luxury	3–3½ %
	Premium/Bridge	2–2½ %
	Mid-Market	1½–2 %
	Value	2½–3 %
	Discount	2–2½ %
CATEGORY	Clothing	1–1½ %
	Footwear	1–1½ %
	Athletic wear	8–8½ %
	Bags and luggage	3½–4 %
	Watches and jewellery	1½–2 %
	Other accessories	2½–3 %

Source McKinsey Global Fashion Index 2016



II. INDUSTRY OUTLOOK 2017

“After a slowdown in 2016 marked by volatility and uncertainty, our analysis suggests a slight recovery next year, where the industry may see 2.5–3.5 percent growth. However, a significant number of fashion heavyweights—especially in the high-end segments—do not foresee any kind of recovery in 2017.”

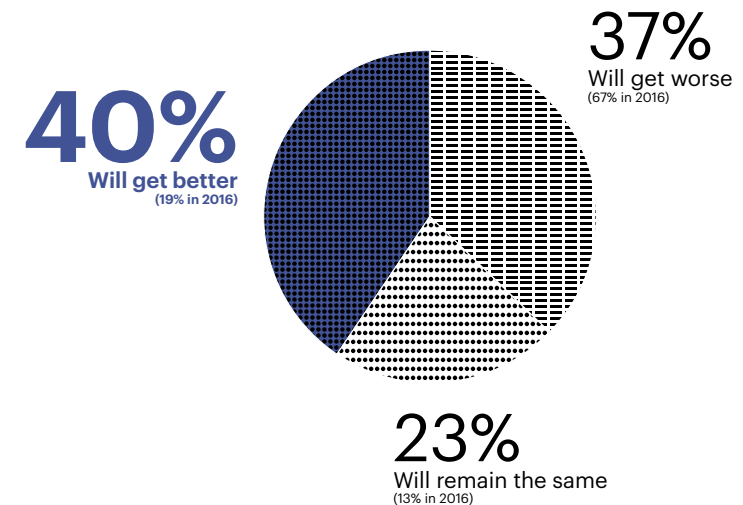
2017 OUTLOOK

After a slowdown in 2016 marked by volatility and uncertainty, our analysis suggests a slight recovery in 2017, to a point where the industry may see 2.5–3.5 percent growth next year. This slight recovery stems from a range of sources. First, macroeconomic indicators, including global GDP growth forecasts, are projected at 3.4 percent compared with 3.1 for 2016⁴⁴, however, at the time of printing, these had not been adjusted to reflect the ongoing impact of political shifts in the United States and the United Kingdom. Second, the investment community expects improvements across the entire fashion industry, particularly

driven by the behemoths within these segments, which are reorganising and divesting non-performing, non-core brands.⁴⁵ This is confirmed by the key executives in the BoF-McKinsey Global Fashion Survey, who also expect increasing growth across categories and sentiments: 40 percent of respondents expect conditions for the industry to improve in 2017 (Exhibit 13). However, it is important to note that 37 percent of respondents expect conditions to get worse and a significant number of fashion heavyweights—especially in the high-end segments—do not foresee any kind of recovery in 2017.

Exhibit 13 40% of survey respondents believe conditions for the fashion industry will improve in 2017

Fashion business sentiment for next 12 months
% of respondents (vs. % sentiment for last 12 months)



Question How do you expect conditions for the fashion industry to develop over the course of the next 12 months?
Source BoF-McKinsey Global Fashion Survey, September 2016

In terms of sales our analysis suggests that the fashion industry will grow 2.5–3.5 percent in 2017, up from 2.0–2.5 percent in 2016 (Exhibit 14). While this represents a slight recovery, it is not yet at the historical 5.5 percent annual growth it enjoyed for many years. Driven by the factors above, and in particular a rebalancing environment in China and North America, growth in 2017 will likely be in line with GDP growth expectations. Given the ongoing impact of political changes across countries and recent election in the United States, world GDP forecasts and other macroeconomic indicators such as oil and commodity prices are highly speculative. Due to continuing global challenges, fashion will not again in 2017 outpace GDP growth by multiple percentage points, as it did over the past decade.

Market segment performance

In 2017, we expect general growth improvements for all segments except discount. The probable winners will continue to be the value and affordable-luxury segments, which we believe will see 3.0-4.0 percent and 3.5–4.5 percent sales growth, respectively. Both segments should benefit from shifts from other segments, as more consumers trade down from luxury to affordable luxury and trade up from discount to value.

Although growth improvement is anticipated for the luxury and mid-market players, they are still expected to underperform in terms of both overall industry growth and their own historical growth. Anticipated growth rates in 2017 for the luxury and mid-market segments are 1.5–2.5 percent, approximately half the rate they

achieved from 2005 to 2015 (6.0 percent CAGR for luxury, and 5.0 percent for mid-market). Nevertheless, this is still an improvement over 2016. Both segments should benefit from the rise of fast-growing e-commerce players, particularly in the mid-market. Growth could also be further impacted by new economic policy in the United States, including international trade and taxation.

However, we expect the discount segment to continue to grow at 2.0–3.0 percent for another year—the slowest-growing of all segments—and below historical growth levels. Some players will almost certainly struggle to grow and defend their market share against value players and discounters offering higher-quality products at low prices, adopting their offer to reach consumers through multiple channels. Others, nonetheless, will likely

continue to grow by expanding their geographic footprint, store networks, and channel offerings. Though growth between 2016 and 2017 will not improve, some players should be able to counter the pressures on the discount segment exerted by the growing value players.

Product category performance

We do not expect a single hero product category in 2017, as most will grow in line with the overall industry, increasing one or two percentage points from 2016. Athletic wear is expected to remain the absolute category winner next year, maintaining sales growth of 6.5–7.5 percent, but this represents a weaker pace than in 2016. Although double-digit growth for athletic wear overall appears to be a thing of the past, its sub-category

LUXURY
AFFORDABLE
PREMIUM
MID-MARKET
VALUE
DISCOUNT

Exhibit 14 In 2017, McKinsey Global Fashion Index predicts fashion industry growth will improve to 2.5-3.5%, in line with GDP but not above

GLOBAL FASHION SALES GROWTH 2015–2017

		FASHION INDUSTRY GROWTH 2015–16		2016–17
GLOBAL	Total industry	2–2½ %	2½–3½ %	
	SEGMENT			
	Luxury	½–1 %	1½–2½ %	
	Affordable luxury	3–3½ %	3½–4½ %	
	Premium/Bridge	2–2½ %	3–4 %	
	Mid-Market	1½–2 %	2–3 %	
	Value	2½–3 %	3–4 %	
	Discount	2–2½ %	2–3 %	
CATEGORY	Clothing	1–1½ %	1½–2½ %	
	Footwear	1–1½ %	1½–2½ %	
	Athletic wear	8–8½ %	6½–7½ %	
	Bags and luggage	3½–4 %	4–5 %	
	Watches and jewellery	1½–2 %	2–3 %	
	Other accessories	2½–3 %	3–4 %	

Source McKinsey Global Fashion Index 2016

of athleisure is expected to continue growing at that pace through 2017.⁴⁶ Watches and jewellery will likely see a single-percentage-point increase in growth rate in 2017 to 2.0–3.0 percent. Although conditions will improve for high-end watches and jewellery, with projected growth of 1.0–2.0 percent, the main growth driver is projected to be mass (fine, costume/silver) jewellery. Overall, the homogeneity projected across product categories makes channel strategy and clear value propositions all the more important for companies to emerge as the winner among product categories.

Sources of growth

Though more positive about industry performance in 2017 than 2016, industry players remain aware of the challenges that lie ahead in 2017. According to survey respondents, the most pressing challenge next year will continue to be

Yoox Net-a-Porter Group at the Borsa Italiana
Courtesy



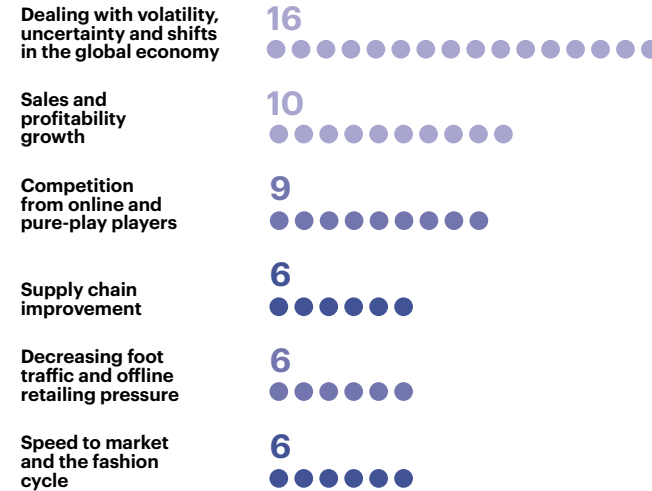
dealing with volatility, uncertainty, and the shifts in the global economy (Exhibit 15), followed by growth in sales and profitability. In addition, fashion executives continue to see competition from online players as one of their top three challenges for next year. Last, supply chain improvements, decreasing foot traffic, and the speed of the fashion cycle weigh equally on their mind as challenges to face in 2017. On the one hand, this combination of challenges underlines the pressures executives will face from the global economy, changes in consumer behaviour, and the internal workings of the fashion system. On the other hand, these challenges are countered by the opportunities they see to improve their performance through focusing on improving the customer experience, omnichannel integration, and the digitisation of the value chain.

Interestingly, in 2017 the fashion industry plans to focus on organic growth over cost

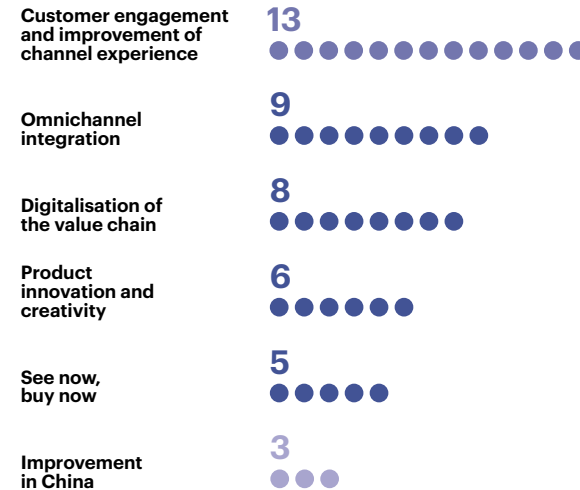
Exhibit 15 Executives continue to name volatility and uncertainty as the biggest challenge for 2017, and improvements in customer engagement as the biggest opportunity next year

% of executives ● Global economy ● Consumer ● Fashion system

TOP 6 CHALLENGES



TOP 6 OPPORTUNITIES

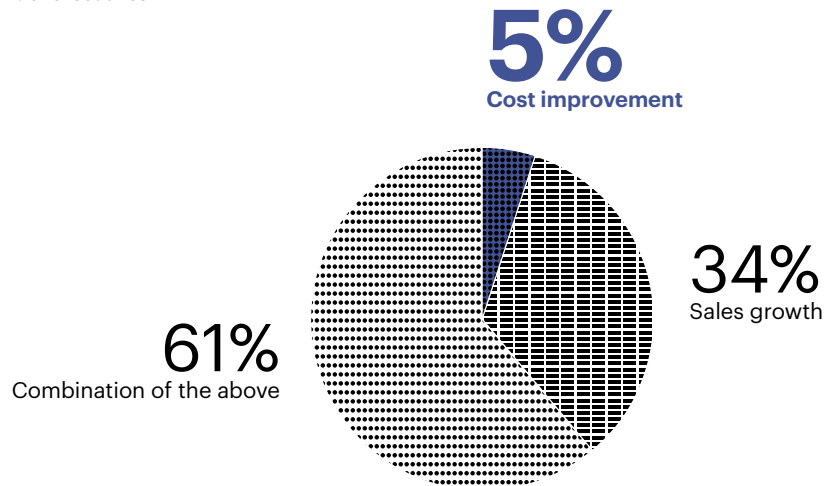


Question What do you think will be the single biggest challenge and the single biggest opportunity for the fashion industry in 2017?
Source BoF-McKinsey Global Fashion Survey, September 2016

cutting. According to the BoF-McKinsey Global Fashion Survey, only 5 percent of business executives believe that cost alone—rather than sales—will be the key focus for increasing profits (Exhibit 16). The sentiment is that the potential to cut costs further is about to be exhausted: over recent years companies have deployed multiple levers to further reduce cost and have still had to find profits elsewhere. This seems likely to produce a renewed focus on top-line growth coupled with an emphasis on continuous performance management. Key investments for growth are expected to come from omnichannel integration, e-commerce, and digital marketing (Exhibit 17). Additionally, organic growth through improved consumer relationship management (CRM) and in-store experiences should remain key drivers in 2017. In an effort to improve profits,

Exhibit 16 Only 5% executives said that they would focus more on cost improvements to improve company performance in 2017

Company focus sentiment 2017¹
% of executives



¹ Responses split into 3 groups to produce pie chart

Question What will you focus more on in 2017 to improve your company's performance?
Source BoF-McKinsey Global Fashion Survey, September 2016

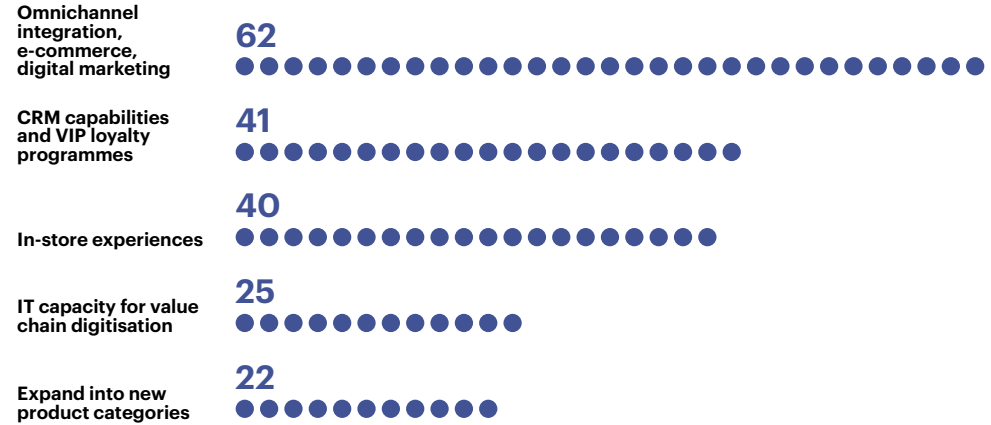
fashion companies will also rely on some cost-improvement levers that go beyond the low-hanging fruit, such as the standard sourcing optimisation. Instead, executives plan to focus on productivity and process improvements, which shows the maturity of sourcing as a lever for cost cutting (Exhibit 18).

In 2017, the fashion industry has the opportunity to stabilise and reset. Next year offers an opportunity for fashion companies to work hard to grow, learning from the lessons of 2016. The ten key trends for next year reflect the complex yet exciting journey the fashion industry can expect. These are derived from a variety of qualitative and quantitative analyses, desk research, expert interviews, the BoF-McKinsey Fashion survey of industry executives and the foundation of existing BoF and McKinsey research.

Exhibit 17 62% of executives surveyed say they will invest in omnichannel integration, e-commerce and digital marketing in 2017

% of executives

SALES GROWTH AND INVESTMENT

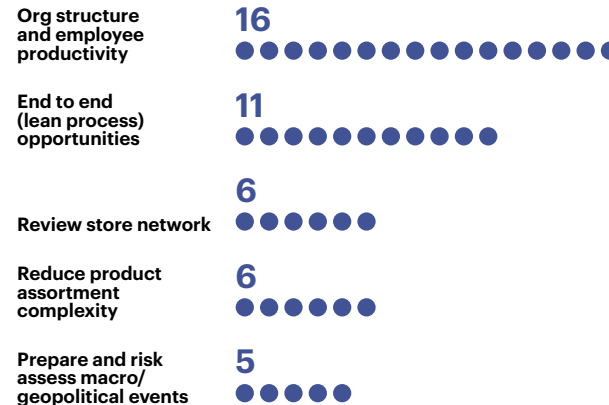


Question What are the top 3 priority areas for your company in 2017?
Source BoF-McKinsey Global Fashion Survey, September 2016

Exhibit 18 27% of executives surveyed say they will reduce costs in 2017 by increasing employee productivity and leveraging lean processes

% of executives

COST IMPROVEMENTS



Question What are the top 3 priority areas for your company in 2017?
Source BoF-McKinsey Global Fashion Survey, September 2016

2017 INDUSTRY OUTLOOK NEW YEAR, NEW PATTERNS

GLOBAL ECONOMY

Volatility intensifies

01.

Volatility is the new normal. Geopolitical instability, terrorism, Brexit, and stalled trade deals will all increase a pervasive sense of uncertainty in the global economy.



A variety of political events remain unsolved and will cause volatility in 2017 as the world adjusts to them

China's comeback?

02.

China's fundamentals, including growth of the middle and upper classes, remain strong and the government's new fiscal policies are expected to improve conditions in 2017, but uncertainty remains

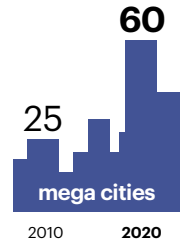


Growth of Upper-Middle class households 2015-2025 helps to secure long-term fundamentals

Urban engines

03.

City-based strategies trump country-based strategies: a new class of rapidly-growing wealthy cities in newly influential markets are becoming central to the evolution of fashion



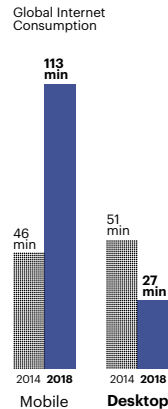
New emerging cities will have larger populations than mature countries, e.g. by 2020 Istanbul > Austria

CONSUMER SHIFTS

Shrewder shoppers

04.

Working harder to keep up with smarter shoppers: 'always-on' consumers will become ever-more sophisticated, more technology-driven, and harder to predict.



The consumer spends more and more of his digital time on mobile devices - by 2018 4x times as much as on the desktop

Generation correlation

05.

Opportunities to serve the young and the old better: fashion companies will need to fine tune and diversify the way they approach both retired and millennials consumers

60+ = 60%

The 60-plus age segment will account for nearly 60 percent of consumption growth in Western Europe and Northeast Asia

THE FASHION SYSTEM

The wellness dividend

06.

Feeling good is looking good: more fashion players will start profiting from the wellness movement, rather than competing with it

3.7% Y-O-Y GROWTH

The amount of money spent on gym memberships/ yoga classes is constantly increasing

Changing the system

07.

"See-now, buy-now" and other disruptions to the fashion cycle: expectations set by the faster pace of fashion and consumer desire for instant gratification must be addressed

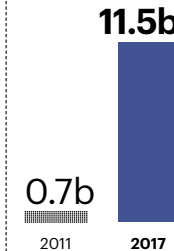


15+ major fashion labels have announced See-Now, Buy-Now collections for 2017

Organic growth

08.

Investing more to nurture local clientele: 2017 will be the year of organic growth by deepening relationships with existing clients, rather than through geographic, channel and store network expansion



Growing a compound annual growth rate of more than 50 percent, the global location-based-advertising market is expected to exceed 10 billion USD in 2018

Upstream technology

09.

Digital innovation goes behind the scenes: digitisation will be the key to supply chain efficiency, lowering procurement costs and the enhancement of sourcing opportunities

25%

25% Fashion Executives see IT capacity for value chain digitization as the key investment area for 2017

Ownership shake-up

10.

Fashion conglomerates will continue to intensify their focus on big brands, creating space for other brands and industry outsiders such as private equity and family owners to acquire targets

P.E.

Strong growth in M&A activity expected in 2017

GLOBAL ECONOMY

01. Intensifying volatility

Every year, MGI asks over 1,600 senior executives across all industries around the globe what they think the macroeconomic and geopolitical environment will look like in the year ahead: for 2017, almost half of them predict that economic conditions will remain challenging and that the world will experience uneven and volatile growth (Exhibit 19). In addition, domestic conflicts and terrorism still cause concern for businesses in many regions, since, as we have seen, they have the potential to disrupt the entire fashion value chain. Indeed, a recent report by the U.S. Senate Committee on Armed Services reflects the potential for an increase in activity from various terror organisations in the year ahead, perhaps to record levels.⁴⁷

Another source of uncertainty is the lingering issue of Brexit, with pending departure negotiations with the EU, thereby beginning departure negotiations with the EU. Anticipation of the impact of the United Kingdom potentially leaving the European Single Market has already caused the British pound to fall to 168-year lows, and it is impossible to say exactly how the negotiations will proceed or to what timetable.⁴⁸ There is also

some uncertainty about the future of existing and proposed trade agreements, including following the result of the US elections: from the African Continental Free Trade Area, currently bogged down in local legislatures, to the Trans-Pacific Partnership, suspended by Washington.⁴⁹

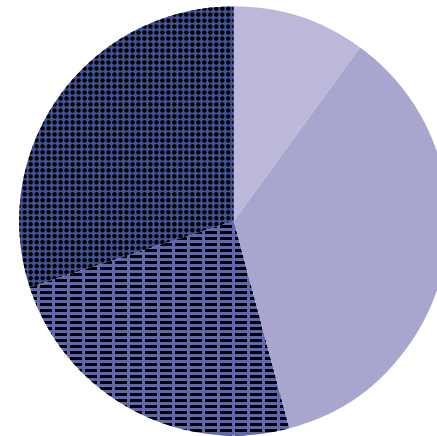
As volatility becomes the new normal in 2017, fashion companies could see all dimensions of their business affected: overall consumer demand, flows of tourism, price adjustments and exchange rate arbitrage, and labour and resource costs. As a result, companies will likely need to adjust their strategies in four ways: 1) adopt a consumer-driven mindset that adjusts in real time to changes in consumer needs; 2) build agile supply chains that guarantee operational readiness; 3) diversify their brand, category, and geographical portfolios: as a top executive of a global conglomerate advised, to balance performance it is important to know how to take advantage of one region while another one is in a downturn; 4) safeguard their cash flow by managing costs. Finally, even the most successful strategy requires an agile organisational model to have impact.

Exhibit 19 54% of global executives believe economic conditions will remain volatile over the next decade

Likelihood of occurrence of global economic scenarios through 2025
n = 1,955

30%
POCKETS OF GROWTH
Uneven, volatile, but high global growth: Uncoordinated efforts to resolve structural and near-term demand challenges lead to uneven success and difficulties in international economic policies

10%
GLOBAL SYNCHRONICITY
Rapid globally distributed growth underpinned by broadening productivity increases: Technology and information flows increase, near-term demand challenges are overcome, major economies tackle structural challenges to growth



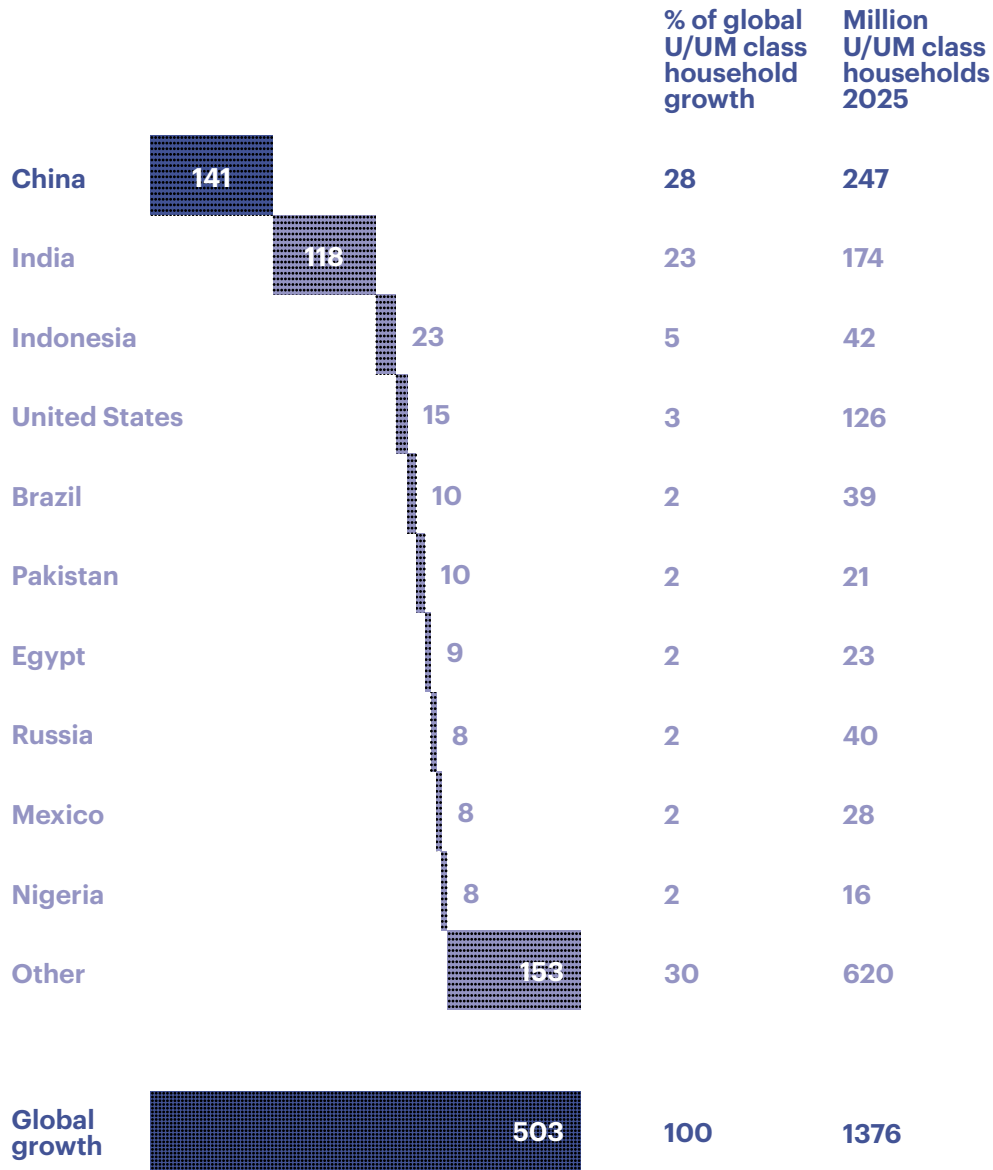
24%
REGIONAL CRISES
Volatile and weak global growth: Near-term demand issues prove too challenging, and long-term structural issues are left unresolved. Financial flows become more volatile, with more frequent and powerful shocks

36%
GLOBAL DOWNSHIFT
Countries navigate near-term demand challenges, but structural challenges linger. International linkages are somewhat strengthened, leading to new opportunities for growth.

Source McKinsey's Global Economics Intelligence analysis; McKinsey Global Executive Survey Results, Sept 2016

Exhibit 20 China will remain central to fashion with 28% of growth in the number of upper middle and upper class households until 2025

Top 10 countries by absolute 2015-25 growth of Upper/Upper-Middle class households # million households



Source McKinsey Global Institute



Alibaba Singles' Day Online Shopping Event
Bloomberg / Getty Images

02. China's comeback?

With China playing such a significant role in the global fashion business, and especially as it has been the source of so much growth over the past few years, the question on everyone's mind is: will China come back in 2017?

Fashion executives believe that the slowdown is temporary. Indeed, over the long term, the fundamentals of China's fashion market are still sound: the increasing wealth of its middle class, the growth of mobile shopping, and the increase in personal consumption. China is still expected to contribute 28 percent of the world's new upper-middle and upper-class households between 2015 and 2025, versus the United States' 3 percent (Exhibit 20). In addition, China is expected to pull further macroeconomic levers in order to stimulate investment and consumption. For instance, rating agency Moody's raised its forecast for China's 2017 economic growth

in the wake of “significant” fiscal and monetary stimulus policies in 2016.⁵⁰ Chinese authorities have shored up the economy through cheap credit and policy support, including the central bank’s monetary easing and lowering banks’ reserve requirement ratios and cutting interest rates. Combined, these factors should offset the reduction in “gifting” consumption that was eliminated through policy changes in recent years.

Chinese consumers will also have increasing access to fashion in 2017. E-tailers such as Alibaba and Shangpin are making fashion more accessible for consumers across the country. Additionally, the growth of mobile has been one of the most significant developments for the fashion industry in China. Historically, consumption of fashion had been driven by travel and tourism: Chinese consumers had to travel to America and Europe, and consumers from third-tier cities had to travel to Beijing or Shanghai to seek out fashion goods. However, the emergence of mobile has made it easier for consumers to access global brands.

Global luxury goods will also become more attractive in 2017. This will be driven by products arriving in China without delays and at the same prices. The shortening of distances and concentration of information will lead to a consolidation of channels. With the growing integration of online-to-offline channels, Chinese consumers won’t need to worry about where to buy from and paying different prices.

Of course, there are also headwinds to contend with. While the internal macroeconomic foundation is solid, pending foreign and international economic policy in the United States due to the upcoming political transition can directly impact Chinese consumption. Further, an economic stimulus does not directly translate to the consumer buying more. For example, after years of rapid growth, brands will also have to reckon with the fact that people’s closets are full, customers are becoming more discerning, and an increasing numbers of Chinese consumers are putting more effort into acquiring new experiences as well as learning, personal improvement, and health.

3. Urban engines

For many years, forecasters have been highlighting urbanisation as a key trend. A new class of rapidly growing cities in newly influential markets is becoming wealthy enough to provide shopping hubs for consumers in a way that makes them for the first time central to the evolution of fashion. Over the last 30 years as many as 400 million Chinese citizens moved to cities, but the new wave of urbanisation taking hold now in China, India, and other populous nations is focused this time on middle-weight cities, which are now beginning to reach key population thresholds, prompting the rise of urban centres that will provide continued growth opportunities for fashion companies.⁵¹ Pune in India and Harbin in China, both middleweight cities in their respective countries, will have seven million and eight million citizens, respectively, in 2017—almost as many as London or Paris.⁵² As these second-tier cities attract more and more residents, and workers and families continue to migrate from rural to urban settings, the opportunities for fashion companies expand accordingly. Over the next few years growth will shift globally toward the east and south, and stem from the urbanisation of emerging cities, as identified by McKinsey’s FashionScope—a city-level growth forecasting tool for the fashion industry.

In the global low-growth environment, what growth does exist will be highly granular and uneven when viewed by categories. It is important, therefore, to look at cities specifically through a category lens. For example, according to projections from FashionScope, between now and 2025 Hong Kong may be the number one city for jewellery sales and the number two for bags and luggage, yet it is not even in the top ten fastest-growing cities for clothing or footwear. When making decisions in

2017, fashion companies need to refine the way they deploy their product assortment at a city level, and assess where to invest in future growth. Cities such as Tianjin in China and Delhi in India are among the fastest-growing jewellery markets, while one of the footwear hotspots is Mexico City. Winning in one city will not necessarily translate into winning across categories and vice versa.

The importance of cities suggests that designs will have to be aimed at specific cities and specific demographics within them. Kuwait City in the Middle East, Guadalajara in Mexico, and fourth-tier Chinese cities are becoming hubs for creativity and product inspiration. More broadly, we should see fashion companies shifting from basing decisions at the national market level, which has become a blunt instrument, and instead monitoring, strategizing, and activating business on a city level. The challenge for global

brands in the next year will be to nurture deeper local relationships with clients in the cities that matter for them.

In addition to tailoring their strategies to local clients and growing urban centres, fashion players that operate in emerging markets should expect increased competition from local brands stepping up their game and professionalising to take advantage of the same opportunity. In the Indian market, for example, overseas mid-market players such as H&M, Zara, Uniqlo, and Mango are now facing competition from India’s own largest retail groups, which are entering the fast-fashion space, aiming to compete not only on price, but on product offering and speed to market.⁵³ Our analysis suggests, that in the coming year more local competitors will try similar moves in Africa, the Middle East, China, Korea, and other important growth markets.

Kuwait City’s skyline
Yasser Al-Zayyat/Getty Images



Q&A 3 INTERNATIONAL VOGUE EDITORS ON URBANISATION ON THE MOOD IN THEIR MARKETS



ANGELICA CHEUNG

EDITOR-IN-CHIEF OF VOGUE CHINA

Cautiously optimistic about China's comeback in 2017

"People here are not easily impressed anymore," cautions Angelica Cheung, editor-in-chief of Vogue China. "Now, even in China, consumers look at their wardrobe and they have everything, so they say, 'Okay, if I get anything new, it must be for a good reason.'"

An increasingly discerning, educated and fragmented consumer profile is not the only issue that luxury brands will have to unpick in China next year. "Now that Chinese are spending overseas, they put more effort into experiences and learning, personal improvements

and health. Anything to do with a healthy lifestyle and a healthy self," she adds.

These and other consumer changes have added another layer of complexity for brands trying to penetrate deeper into China, especially at a time when its economy has been slowing. Deceleration of Chinese market growth has taken a heavy toll on the global luxury industry, which has come to rely heavily on the region and given rise to concerns about its future.

"Everything is changing; the world is changing; China is changing.

And in China, because it was complicated to start with, it's even more difficult for people to catch what's happening," she concedes.

"This is what Vogue China is trying to do: introduce a certain structure into a chaotic market," she adds, referring to the magazine's newer services providing creative and marketing solutions for luxury brands.

Cheung is optimistic that the Chinese market will get back on track, likening much of the current spending slowdown to a "passing mood" among consumers that is an inevitable consequence of the volatility of the Chinese stock market in 2016 and ongoing questions around the long-term stability of the property market.

"Obviously when you've just lost millions on the stock market, you are not in the mood to go out and buy diamonds or an Hermès bag," she concedes. "Some kind of market adjustments [do] affect how people spend, but usually that's quite temporary."

The ongoing urbanisation of the country and growth of its third- and fourth-tier cities provide longer-term growth opportunities, believes Cheung. "China is still a growing market and...there are a lot of other Chinese cities still waking up to this whole new world [of luxury fashion]."

"You can't really treat China as one whole thing. The North, South, East, West, Centre — they are all different. The climate is different, the lifestyle can be different, the language is often very different and what they are influenced by is different."

Another very distinctive demographic in the country is the millennial consumer, a segment many luxury brands are turning their focus towards and one that Cheung understands well, having this year launched Vogue Me, a bimonthly spin-off magazine targeting China's post-1990s generation.

"It's a totally different generation. You need to know how their mind works and how you influence them and who influences them. It's the 'Me Generation.' It's about my identity, it's about my feelings, it's about how I see the world. They're not just a younger version [of the existing consumer]. That's why I was adamant I wouldn't call it Vogue Girl or Teen Vogue [because] I don't want people to mistake me for just doing a younger Vogue."

Young Chinese consumers like the readers of Vogue Me have significant spending power but they also have very different attitudes and values in comparison to the next generation up. Typically, they are less wedded to brands and more open to mixing global brands with local labels and at a variety of price points.

As for whether local brands will be a growth vector in 2017, Cheung is cautiously optimistic. "I went to the shopping mall a couple of months ago and...I feel that a lot of the Chinese brands are doing much better products now because they've been learning fast...some of them are becoming a lot stronger."

"Unfortunately, they came into the market when all the international brands had a great growth period. But now it's coming into a slight adjustment period so it's a confusing period [for them ahead]."

"Obviously when you've just lost millions on the stock market, you are not in the mood to go out and buy diamonds or an Hermès bag," she concedes. "Some kind of market adjustments affect how people spend, but usually that's quite temporary."



Vogue x Bvlgari Event In Beijing
VCG/ Getty Images



DEENA ALJUHANI ABDULAZIZ

EDITOR-IN-CHIEF OF VOGUE ARABIA

Key cities will continue to drive the Middle Eastern market

"I'm the only editor-in-chief I know who was a retailer," says Deena Aljuhani Abdulaziz, the Saudi princess who was appointed editor-in-chief of Vogue Arabia, a new Condé Nast edition that launched in 2016 as a digital-first publication. The print magazine is due to be released across the Middle East and North Africa (MENA) region in early 2017.

"It's 250 million women; 21 countries. Arabs are ready for Vogue; it's long overdue," adds Abdulaziz, who for 10 years owned a multibrand designer fashion boutique called D'NA with branches in Riyadh, Saudi Arabia and Doha, Qatar.

Highlighting the diversity of the Arab market region, Abdulaziz points to the very distinctive nature of the urban markets that she will target next year. Beirut, Lebanon and Cairo, Egypt remain very important but the region has experienced instability.

"Kuwait City is very interesting and cool and I think it will keep on going for a long time. The reason is that the natives, at one point, started to understand that they don't necessarily have to travel

to shop, and Kuwait's market is all about the natives. You don't see foreigners as much."

"I think that Doha has definitely tried to learn from Dubai's mistakes," she says. "So Doha has always separated itself as trying to be the cultural centre, a little bit of a sophisticated outlook... But Jeddah has become interesting and Vogue Italy just did an event there — though it's not where the [biggest] spending is. Riyadh is definitely where the money is."

In addition to their unique demographics and variety of wealth profiles, the major cities of the MENA region can have very divergent styles and tastes. Designs popular in Jeddah are not necessarily popular in Riyadh, for example, even though they are both in the same country, Saudi Arabia.

"It's just like [the differences between] Miami and Los Angeles or comparing Washington to New York," she says. "We are global citizens."

"It's just like Miami and Los Angeles or comparing Washington to New York. We are global citizens."

KARLA MARTINEZ

EDITOR-IN-CHIEF OF VOGUE MEXICO & VOGUE LATIN AMERICA



Latin American fashion players come into their own

"We all speak Spanish but very different culturally one of my biggest challenges is to be sure that we're speaking to these different countries."

"A lot of people don't understand this [but] we do two issues every month," says Karla Martinez, the editor-in-chief of Vogue Mexico and Vogue Latin America.

"First we do the Latin America edition, which means the whole region except Brazil [which has its own separate edition of Vogue in Portuguese] and the Caribbean. We also put special local inserts in our edition for [distribution in] Chile, Peru and Colombia and then we do our Mexican edition, which obviously goes to Mexico."

Martinez, who was appointed in June 2016, explains: "We all speak Spanish but [we're] very different culturally [so] one of my biggest challenges is to be sure that we're speaking to these different countries. Especially now that the Latin American region has really come into its own in terms of [local] fashion."

"Colombia has had an amazing fashion industry for years [and] now you've got people like Johanna Ortiz who has built an amazing business. In Mexico, there's a lot of amazing textile industry artisans [and] in Buenos Aires, for example, you can get really cool [unique] men's fashion. So I think there's kind of

been an awakening... that you can create amazing products [here] and people will want them."

So far, Brazil, Mexico and Colombia have dominated the scene both in terms of spending power and the influence of their local fashion weeks. "There's [already] a lot more people buying local Mexican and Colombian design [and] when the dollar and the euro are so strong, you get less of us Latin Americans [shopping in Europe and North America but] that is an opportunity for our own fashion industries here," she explains.

Now, even more Latin American retailers are beginning to accent their international product offering with local designers scouted at growing South American fashion weeks held in Buenos Aires, Argentina, Santiago, Chile and Lima, Peru. "Peru has a huge cotton industry and now they have some interesting fashion too," she says.

Some regional retailers have recently begun to source hard-to-find merchandise from smaller Central American fashion weeks in Guatemala, Honduras and Panama. "I think people are kind of specialising in what they do best."

McKinsey FashionScope

One of the most dramatic aspects of global development is the growing power of cities and the extreme growth and concentration in a limited number of megacities. According to McKinsey Global Institute, the world's top 600 cities (in terms of absolute GDP growth) are expected to drive almost two-thirds of global economic growth by 2025.⁵⁴ This urbanisation is also seen in the developed world, but massive urbanisation will continue across emerging markets, which is where three-quarters of these large cities are located. In 2025, there will be 60 cities with a population of at least 10 million, or megacities—more than double today's number of urban behemoths—where GDP will exceed \$250 billion. Tianjin's GDP, for example, will be the size of Sweden's GDP in 2025.

This extreme growth concentration offers an immense opportunity for fashion brands and retailers. Accordingly, FashionScope is a tool developed by McKinsey to help them navigate and prioritise cities and focus resources in targeted market-entry plans.

Methodology

MGI has developed a proprietary methodology called CityScope, which builds on broad sets of economic and demographic data for more than 2,600 cities around the world, and combines them with country and market understanding to forecast growth at city level. Adding to this a deep market understanding of the specific drivers of fashion growth allows us to provide a fashion-specific view—FashionScope—that forecasts growth globally and at a city level in some detail.

The analysis covers five categories across all market segments: clothing, footwear, athletic wear, jewellery, and personal accessories. For each one, we looked to identify the precise factors that drive growth—from real GDP to real price, gender balance, share of low-to-high income households, and tourism—to see which were the most important in predicting growth.

Looking at more detailed segments, the more surprising the answers become.

It is widely acknowledged that growth in fashion is shifting to China and emerging countries in Asia Pacific. The FashionScope analysis indicated that by 2025 approximately 31 percent of global fashion sales will come from China, while another 11 percent will come from the emerging countries in Asia Pacific. Today these two regions combined account for just 30 percent of sales. As these regions grow, the share of more developed regions—especially Europe and North America—will decrease.

More interesting is the concentration of that growth in cities, particularly those of emerging-market countries. These countries have more than 400 middleweight cities, which are expected to account for 50 percent of global GDP growth by 2025. Between 2015 and 2025, the majority of the top ten fastest-growing fashion cities are in emerging market nations, including Shanghai, Chongqing, Shenzhen, Mexico City, and Delhi. Nonetheless, mature cities remain important in terms of absolute size, and are also continuing to grow. New York, Tokyo, and London in particular remain some of the biggest fashion markets across all categories (Exhibit 21).

The most unexpected insights come from looking closely at what drives growth in specific

segments. The different market segments have very different drivers. High rates of tourism translate into higher sales of bags and luggage and personal accessories, but jewellery sales depend much more on the share of the female population (where self-purchase is on the rise).

Analysing long-term fashion growth at city level

Growth is also granular and varies by category and city. Over the next decade, as the fashion industry grows, value is expected to shift across categories. Some categories, such as athletic wear, footwear, watches, and personal accessories, should remain relatively stable, continuing to make up approximately 40 percent of the market. These categories are driven by common macroeconomic factors, such as category price and share of high-income households.

The main anticipated shift involves jewellery growing in relative importance at the expense of clothing. Two main factors are behind this development. First, urban consumers should be able to redirect a larger share-of-wallet from basic needs—clothing and food items—to discretionary needs such as healthcare, education, recreation, and personal purchases, including jewellery. This shift is happening particularly fast in China; while basic consumption, including clothing, accounted to almost 70 percent of consumer spending in 1985, this figure is projected to be roughly 30 percent in 2025. Second, growth in the number of households in China and India, which are traditional jewellery-consuming countries, and the general growth of high-income households—which are expected to grow by 78 percent globally over the next ten years—will likely have a direct impact on the growth of jewellery sales over the long term.

What it takes to win in one category in one city is not necessarily the same as what it will take in a different category in the same city, or the same category in a neighbouring city. At a time when organic growth is essential but resources for investment are in short supply, FashionScope offers granular insight into the specific drivers of success for each category in each geography.

Exhibit 21 New York, Tokyo and Los Angeles will continue to be among the top 10 largest fashion markets by 2025, but new emerging cities including Beijing, Mumbai, and Shanghai will enter the rank

Ranking of largest cities by 2025 sales forecast
 (#) Rank in 2015
 (-) New to Top 10 in 2025

FASHIONSCOPE 2025

1
2
3
4
5
6
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8
9
10

CLOTHING

TYO

Tokyo	(1)
New York	(2)
London	(3)
Los Angeles	(4)
Shanghai	(9)
Beijing	(-)
Osaka	(5)
Rhein-Ruhr	(6)
Chicago	(7)
Chongqing	(-)

FOOTWEAR

NYC

New York	(1)
Hong Kong	(2)
Tokyo	(3)
Los Angeles	(4)
London	(5)
Shanghai	(-)
Mexico City	(7)
Buenos Aires	(8)
Beijing	(-)
Chicago	(6)

ATHLETIC WEAR

NYC

New York	(1)
Los Angeles	(2)
Tokyo	(3)
London	(4)
Houston	(6)
Chicago	(5)
Dallas	(8)
Washington	(7)
Hong Kong	(-)
Shanghai	(-)

JEWELLERY

HKG

Hong Kong	(1)
Shanghai	(5)
Beijing	(6)
Chongqing	(8)
New York	(2)
Tianjin	(-)
Guangzhou	(-)
Shenzhen	(-)
Tokyo	(3)
Mumbai	(-)

BAGS AND LUGGAGE

HKG

Hong Kong	(1)
Tokyo	(2)
New York	(3)
Seoul	(5)
Osaka	(4)
Los Angeles	(6)
London	(8)
Singapore	(7)
Taipei	(-)
Shanghai	(-)

CONSUMER SHIFTS

4. Shrewder shoppers

In 2017 consumer needs and behaviours will likely become more sophisticated, more technology-driven, and harder to predict than ever, with and fashion companies striving to keep up.

Today's consumers are "always on"—better informed, better connected to others, more demanding, and more conscious of values and authenticity—and yet perhaps more unpredictable (Exhibit 22). This is a new consumer altogether who chooses to blend elements from different brands and designers, and shops more broadly than was common in the past. The driving forces behind their behavioural changes are the availability of information and accessibility of brands, as well as the desire for personalisation and connection to deep-rooted values. With brand promiscuity on the rise and more consumers inclined to shop across market segments, the market is becoming increasingly complex for brands that have relied on tradition-

Exhibit 22 In 2017, the shrewder shopper will be characterised by 6 main qualities



Source McKinsey

ally loyal consumers buying from a particular segment of products.

The changing competitive landscape—more brands, more channels, more retailers—should further amplify the complexity of the consumer. Brands will likely need to rethink the future of the store and focus on a customer-experience redesign, particularly by leveraging the omnichannel consumer decision journey to create a seamless consumer experience. This may take the form of stores being reshaped to resemble the online experience more closely, or amplifying the mobile and digital connections available in-store, and introducing the notion of community-based retail.

As consumers engage with technology to enhance their shopping behaviour, brands can leverage this to their advantage and further gain insights into their consumers. Investment in CRM is crucial for 2017. More than ever, fashion brands need to have a global view of their consumers in order to understand what they want, what they like, what they don't like, and where and how they shop. Consumers have so many choices that fashion companies need to

leverage the information they have to segment and then segment again. Emerging brands have been founded on the realisation that there are many untapped consumers for whom today's fashion brands fail to cater. These emerging brands, such as Olivia von Halle, Cambridge Satchel Company, Mansur Gavriel, and Common Projects, are scaling up niche businesses through best-in-class or best-in-category strategies, or building a business on the strength of a single best-selling product.⁵⁵

At the same time, new technologies are coming online, often with the promise of opening new sorts of connections with consumers. Virtual reality is a big theme, with some companies rolling out immersive fashion show access, while others are developing mobile payments infrastructure, such as Alibaba's VR pay, which aims to allow customers to purchase items with simply the nod of a head for those connected to a brand show.⁵⁶ The winners of 2017 will probably be those companies that invest in the right technology to help them understand and serve their consumers and tap into their currently unmet needs.

VR shopping technology Buy+ VCG/ Getty Images



5. Generation correlation

Two key but contrasting consumer groups are about to grow exponentially: the elderly and retired and the millennials. To succeed, fashion companies will likely need to focus the way they serve both these groups.

McKinsey's analysis suggests that the number of retiring and elderly people in developed countries will grow by more than one-third over the next 15 years, from 164 million to 222 million⁵⁷; by 2025 the global population aged over 60 should reach 30 percent in advanced economies and 13 percent in emerging economies (Exhibit 23). This translates to 51 percent of urban consumption growth in developed markets, or \$4.4 trillion, in the period to 2030.⁵⁸

This is a significant opportunity for fashion, so brands should identify ways to reach and communicate with these valuable consumers. Part of the challenge will be to balance the call by some for an ageless approach, whereby brands are more fluid in their designs, rather than designing for a particular age group, with

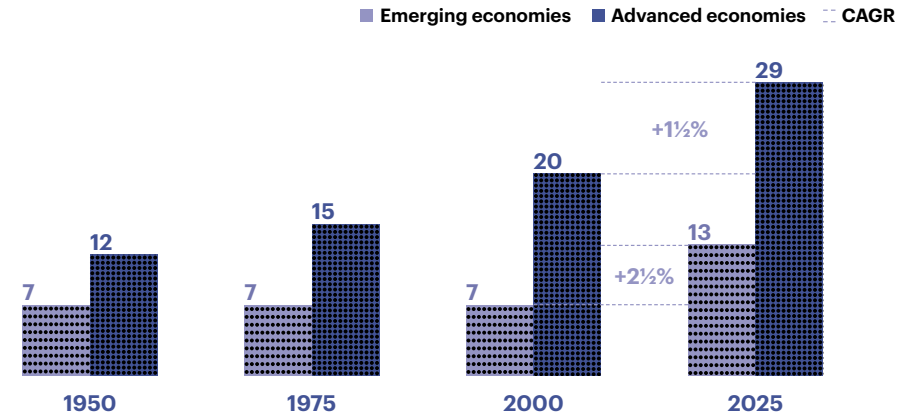
the reality that there are others who are nevertheless conscious of age-appropriate fashion. In the words of fashion icon Iris Apfel, "I think a woman has her own style and knows who she is; she doesn't have to dress for being 60 or 20 or 90."⁵⁹



Kevin Schafel/ Getty Images

Exhibit 23 Almost 30% of the population in advanced economies will be over the age of 60 in 2025, just 13% of emerging economies but growing at higher pace

Population over the age of 60
%



Source McKinsey Global Institute

The second most important growing consumer segment is the millennial generation. As of spring 2016, millennials are the largest living generation in the United States; over the next decade their total income of \$1 trillion is expected to grow to be 30 percent more than that of Generation X and 7.5 times that of the Baby Boomers.⁶⁰ On a global scale, 85 percent of them live in emerging markets and have a spending power of approximately \$2.5 trillion, which is expected to grow three times by 2025.⁶¹ However, capturing that opportunity requires engaging more effectively with millennials and responding more quickly to their needs.

Doing so depends on understanding the underlying attitudes and behaviours that drive millennial consumers to spend their money on fashion, starting with the fact that they should not be categorised as a single group but as distinct attitudinally driven segments of consumers. According to the 2016 McKinsey

Millennial Survey of 11,000 US consumers,⁶² the key drivers for millennials can be divided into three: value, quality, and image. Different segments of consumers emphasise some drivers more than others, creating niche segments – a segment that is motivated by price; a segment that cares less about the brand; a segment that makes controlled and thoughtful decisions; a segment driven by self-expression; and a segment willing to pay premiums, among others. Much more compelling for millennials than other age groups, according to McKinsey, is the idea that they are global citizens living in borderless environments with converging education and culture, and are values driven in search for meaning and a connection to brands.

In 2017 fashion companies should consider tailoring their strategies for the old and the young not by focusing on their age, but by identifying the distinct values that resonate with members of those two groups.



Q&A

DANIEL LÓPEZ

VICE-CHAIRMAN AND MEMBER OF THE BOARD OF DIRECTORS AT MANGO

Deepening consumer relationships over expanding the store network

“There are certain areas of the world where we’re present that the forecast for the next 12 months is not very optimistic,” concedes Daniel López, who, in less than a decade, rose from Mango’s legal management team to the rank of vice-chairman.

Citing the ripple effect of terrorist activity and other forms of geopolitical instability in markets such as the Middle East, Russia and the CIS countries, López acknowledges that there will be challenges facing the Spanish fast fashion brand in 2017.

“Number one [is] uncertainty and volatility linked to currency exchanges... like the rouble and the dollar [and] there are all these Brexit consequences that everyone is still discounting but we have still yet to see over a 12-month period,” says López, who has overall responsibility for the areas of retail, franchise management and global expansion.

Given how exposed Mango is across international markets, López admits that it will not be easy to mitigate uncertainty and maintain growth. The company currently operates over 2,200 own-brand stores in 109 countries around the world. Approximately 80 percent of brand turnover corresponded to markets outside Spain in 2015.

Yet López is confident that there are ways for Mango to expand next year despite the volatile climate in some territories. “We are going to be cautious depending on the market but we are not going to decelerate our expansion plans,” he says.

“Our focus right now is to be more capillary in markets that account for the biggest percentage of our turnover, so this is going to be mainly big markets in Europe [and] Russia now that the situation

seems to be a little bit more stable. This means also growing in the Middle East.”

Rather than conquering entirely new emerging markets, López will boost the company’s presence by penetrating more deeply in substantial but still underserved cities where the brand has already proven itself.

“We’re going to keep more or less the same number of stores [but] work towards transforming into a network of stores where we can establish a more clear relationship with our customers rather than the transactional type of stores that we used to have.”

“We come from a footprint of stores that has an average of 300 square metres [so] what we’ve been doing since 2013 is to change this footprint into...the region of 800 square metres on average — including the majority of the womenswear, plus kidswear, plus menswear. This is a process...which is still far from being finished so we have this idea of growing another 100,000 square metres...in 2017.”

By bringing a greater assortment of merchandise and a wider selection of ranges into larger format megastores, López aims to expose consumers to a more comprehensive vision of the brand universe and thereby create a deeper connection. He plans to enhance the relationship further by improving the localisation of the offering and increasing speed-to-market. To this end, the company has completed a colossal new logistics centre in Lliçà d’Amunt, outside Barcelona.

“Since our [expansion] project is medium to long-term...we have a commitment to build this one-to-one relationship with the consumer irrespective of the macro-economic situation [in 2017],” he says.

“Since our project is medium to long-term... we have a commitment to build this one-to-one relationship with the consumer irrespective of the macro-economic situation”

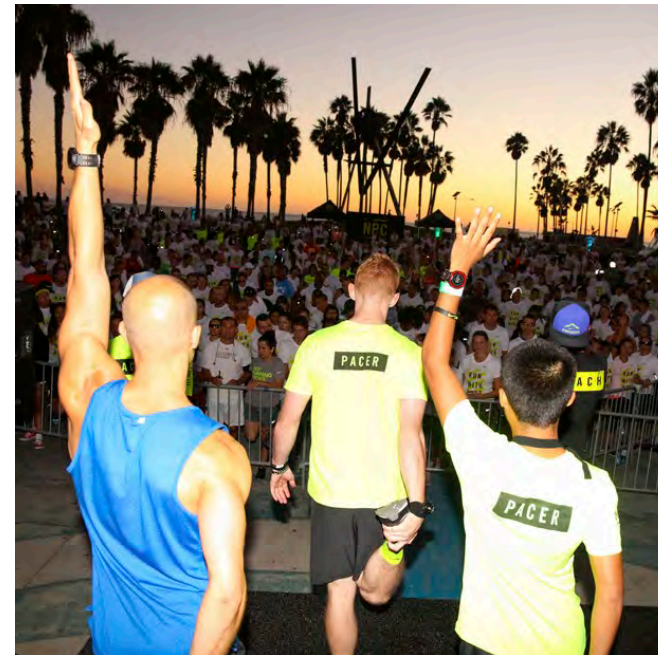
6. The wellness dividend

Traditionally, wellness and fashion have not been allied industries, but the rise of the wellness movement leaves fashion players with the choice of either learning to profit from it or having to compete with it. Over the past couple of years, fashion companies have started to pay attention to new lifestyle trends founded on health and wellness— hence the rise of casualisation and athletic wear. To take advantage of this opportunity, fashion brands have released their own athletic wear and activewear lines. An evolution of this product offering has been to present wellness experiences to customers, an approach that chimes with the younger and more active segments of the customer base. Examples include some of the Nike running clubs and Reebok’s mobile CrossFit gyms.⁶³ These events and other experiences are important, as the consumer segment is interested in personal, transformative experiences, often on the journey to a “better you”. They also help create differentiation in segments such as

running shoes that would otherwise be tending toward commodities.

Currently, fashion is responding to only some, and often isolated, layers of the wellness movement. It has focused predominantly on the physical component, responding to people’s desire to be more physically fit. Some brands have focused on storytelling and creating an emotional connection of wellbeing to consumers, while others have championed consciousness for the environment and the use of organic fabrics. However, our expert interviews indicate that this is a limited interpretation. Wellness extends to a more holistic sense of a person and appeals to mental, physical, spiritual, emotional, and environmental attributes. The more of these attributes that a brand can reflect and connect to, the stronger it will be, and the deeper the relationship it can create with the consumer. Today, however, fashion’s offer is not sustainable because it does not connect to the whole person, but only a part.

Fashion companies can both benefit from the wellness movement and compete with the wellness industry by adopting a more holistic view of its consumers in 2017. The alternative for the consumer will be to spend a larger share of wallet on other products and services that do just that. The fashion industry can make that connection by extending its repertoire and value touch points, and by basing its proposition on making a person feel good beyond simply making a person look good.



Nike + Run Club And Kevin Hart Pop Up Run
In Venice Beach, CA
Brian Gove/ Getty Images

THE FASHION SYSTEM

7. Changing the system

In 2017, the fashion industry will await with baited breath the outcome of the recent disruptions to the fashion cycle. From the see-now, buy-now movement to joint menswear and womenswear presentations, 2016 was a truly disruptive year for the fashion cycle. Vertical retailers initially increased cycles mainly by implementing flash programmes and open-to-buy. Decisions in the higher-end segments to change the timing of the sell-in process will have ripple effects across the entire industry as all brands face the need to adjust to the best competitive model and number of product drops for their business.

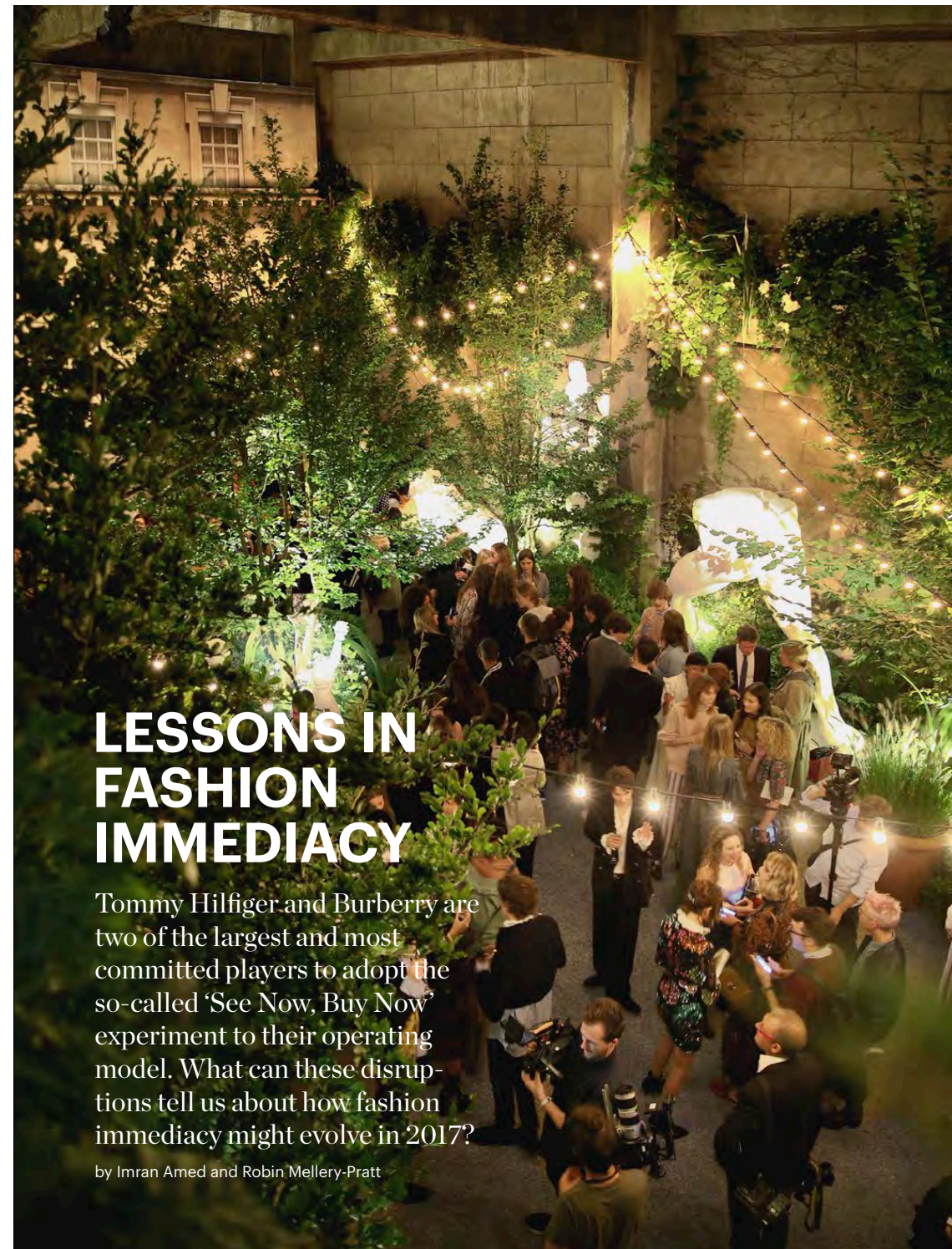
Early results from the see-now, buy-now collections launched in September 2016 point to the possible evolution of this model. Beside its novelty factor, which has garnered media attention and served as a valuable marketing platform, the brands pioneering the model are reporting positive figures. For instance, straight after the Tommy x Gigi runway event, several of the under-\$100 pieces were already sold out online.⁶⁴ The day after Burberry's show, its Regent Street boutique sold out several styles from the collection before noon, and many key pieces appeared to be sold out on the brand's website within the week.⁶⁵ Bergdorf Goodman declared that it had its largest Tom Ford day

of the year following the New York show.⁶⁶ For advocates of this change, the move to immediacy is a step in the right direction for the fashion industry as it gives more consumers access to the fashion shows, and it adapts to the way consumers want to shop and behave.

The official financial results will be seen over the course of 2017 as brands release the figures for their full retail seasons. At the moment it is not clear how many SKUs sold out after the see-now, buy-now collections were released, whether brands and retailers replenished those items after the show, and how accurately they forecasted demand for the remainder of the season. Even if the financial results are positive, there are questions surrounding the impact of this new model have on production and manufacturing processes, and the investment required to get there. More importantly for high-end brands, there is uncertainty about how it may impact creativity.

The optimum model is not clear cut and the decision to adopt a new cycle will likely depend on the creative process, the brand, the product category, and a company's distribution, among other factors. That said, brands are prepared to adopt new models if the consumer forces ultimately trump the status quo.

Courtesy Burberry



LESSONS IN FASHION IMMEDIACY

Tommy Hilfiger and Burberry are two of the largest and most committed players to adopt the so-called 'See Now, Buy Now' experiment to their operating model. What can these disruptions tell us about how fashion immediacy might evolve in 2017?

by Imran Amed and Robin Mellery-Pratt

LONDON, United Kingdom — Following months of industry speculation on the subject, on February 5th 2016, Burberry became the first major fashion house to announce a realignment of its show calendar by combining men's and women's collections into twice-annual seasonless shows. That very same day, Tom Ford announced a plan to postpone his fashion show for six months to show in September and make the collection immediately available to consumers.

Within a week, they were joined by Tommy Hilfiger, Paul Smith and a number of smaller designer brands — all publicly announcing a shift to some form of fashion immediacy strategy, seeking to better rationalise the fashion show calendar for consumers and capitalise on immediate demand for runway products.

However, the global fashion industry has been neither united nor unanimous in its view on this break from tradition. In fact, some of its most influential figures went on record against the shifts in strategy, including senior representatives of the two biggest luxury fashion conglomerates LVMH and Kering, as well as the leaders of national fashion associations such as the *Fédération Française de la Couture du Prêt-à-Porter des Couturiers et des Créateurs de Mode* and the *Camera Nazionale della Moda Italiana*.

Kering's chairman and chief executive François-Henri Pinault said in a statement that fashion immediacy “negated the dream of luxury,” and that delayed gratification (rather than instant gratification) is what “creates desire.” The task force put together by Ralph Toledano, president of the *Fédération Française de la Couture*, which comprised of Sidney Toledano, chief executive of Christian Dior, and Bruno Pavlovsky, Chanel's president of fashion, amongst others, took the position that, “the present system was valid.”⁶⁷

While some industry leaders — based mostly in New York and London — advocated for rapid change, the French and Italian designer establishment seemed to prefer the status quo. And given the latter's collective weight in the global fashion industry, the move toward fashion immediacy became a matter for companies to tackle individually.

Despite the industry's internal divisions, a variety of fashion immediacy strategies have emerged throughout 2016. Some of these reflect a longer-term evolution that has been sweeping the industry in recent years. As high-street players increasingly adopted the fast-fashion business model, more high-end designers introduced pre-fall, cruise, resort and holiday collections. This effectively increased the pace and number of deliveries from the traditional Spring/Summer and Autumn/Winter seasons.

Consequently, today, many luxury brands present six shows for the three different ready-to-wear collections: two each for womenswear mainline, womenswear pre-collections and menswear. But although they had increased the number of product drops throughout the year, brands found themselves creating publicity around these collections months before consumers were able to buy them at retail.



TOMMYNOW Women's Runway Show Fall 2016
Grant Lamos IV/ Getty Images

“It's always felt a little alien, inviting people from around the world to tune in and to watch, to Instagram, share and like and all of those things, but then not be able to buy it, or look at it, until four to six months [later]. I found [the shift to fashion immediacy] great — a natural thing,” says Christopher Bailey, chief creative officer and chief executive of Burberry.

Looking ahead, several contemporaneous factors will continue to drive the industry's adoption of fashion immediacy strategies in 2017. The first is the need for organic growth in a challenging global economic climate. Ninety-five percent of the business executives polled in the BoF-McKinsey Global Fashion Survey, believe that

driving sales growth, rather than cutting costs, will be the key focus to increase profits in 2017.

Brands can view fashion immediacy as an attractive potential growth lever, to address the traditional fashion system's inability to concurrently serve the needs of a global consumer base and to better capitalise on the media and consumer interest in fashion shows.

Another factor is the belief that some consumers demand fashion immediacy and view it as a natural progression for fashion brands. “We listened to the consumer and understood that [what] they are y demanding is instant gratification and experiences,” says Tommy Hilfiger, founder and designer of his eponymous brand.

Arguably, the rise of B2C fashion shows, photo-sharing social media apps and e-commerce have already shifted consumer preferences toward immediate gratification and heightened expectations for newness. Some believe that changing the fashion cycle is simply a sign that brands are catching up. “The traditional ‘attraction of anticipation’ will still exist, but there has to be some change. We are living in a radically different world,” says Bailey.

But what does it take for fashion brands to operationalise fashion immediacy to their consumers — and is it worth it?

Aligning Everyone to a New Internal Calendar

To disrupt the established fashion calendar, which fails to take into account seasonal differences in southern and northern hemisphere markets, Burberry and Tommy Hilfiger completely shifted execution deadlines and decision-making processes. “It took a lot of work to recreate our calendar. We had to have intense synchronisation across every different aspect of our business,” explains Avery Baker, chief brand officer at Tommy Hilfiger and the chief-architect of its move to fashion immediacy.

Previously, samples would have been debuted at the runway show, but the new schedules mean they are made around three months before the show.

“You normally design the full show, then you show the show, and then your supply chain starts to kick in,” Bailey told BoF when he announced the change.⁶⁸ But for the latest Burberry show, Bailey had to develop production techniques, deadlines and budgets as a part of the design process. “Now, as we are designing the show we will be passing things over immediately to our supply chain partners to say, ‘Let’s look at the lead times on this; how can we work with this factory to get this on the date that we need it?’” he continues.

There are also implications for wholesale partners and press, who must see the collection before the show and place their orders in advance. Restricted showrooms were set up for key international wholesale buyers and press to view the collection in the strictest of confidence, at times secured through non-disclosure agreements. In Burberry’s showroom, accessories were also displayed as well as inspiration boards with images, photographs and swatches of fabric to give the clearest possible sense of the collection’s themes.

A Positive or Negative Impact on Creativity?

More pessimistic observers have questioned the impact of fashion immediacy on the creative process, predicting that collections would inevitably become watered-down, overtly commercial or lack the dream and anticipation that have sustained fashion marketing for decades. But according to both Bailey and Hilfiger, rather than a creative constraint as detractors claim, the earlier deadlines brought on by fashion immediacy strategies offer time for reflection and can therefore award creative advantages.

“It gave us time to unpack the inspiration, the stories, the artisans that went behind it, the craft that went behind it [and] the music that was the spirit of the collection,” says Bailey, who created an art and craft infused collection and exhibition for the Burberry collection presented in September 2016 at Makers House, where artisan weavers, bookbinders, calligraphers and saddlers — all linked to London concept store The New Craftsmen — were on hand.

The move to fashion immediacy has been very important to help Burberry “join all of the dots,” he explains, so that audiences around the world avoid a transactional relationship whether they be in store, on social platforms, or elsewhere.

“It’s always felt a little alien, inviting people from around the world to tune in and to watch, to Instagram, share and like and all of those things, but then not be able to buy it, or look at it, until four to six months.”



Courtesy Burberry

Baker says that Tommy Hilfiger’s pivot toward fashion immediacy was also a boost for creativity: “It was an extremely dynamic process, having that adaptability and agility to find interesting and fresh ways to tell the story, we actually found [it] to be super creative. I think our own team was even inspired and surprised at how the final show came together because it felt really fresh,” she says.

Bailey goes so far as to call claims of fashion immediacy’s negative impact on creativity “an incredibly patronising” argument. “We designers are not stupid; we do have brain cells and we’re not constrained by timings. We will find solutions to these problems,” he asserts.

There are, however, some creative aspects where the shift in timing is absolute. Communications assets for the new season must now be immediately available following the show, impacting the highly pressured work schedules of the creative teams who craft communications strategies, from photographers to art-directors, make-up artists to hair stylists. In September 2016, when Mario Testino took his place front row at the Burberry show, he had shot the accompanying ad campaign, which was already in the hands of Anna Wintour, American Vogue’s editor-in-chief, to run in the magazine.

In practice, it seems likely that maintaining “the dream” aspect of luxury will be sustained through key runway pieces. For example, Burberry’s military band jackets featured heavily in the show as well as the advertising imagery and editorials which came afterwards. The ability to presage what runway looks to manufacture in significant numbers and balance them with commercial pieces will define early success with the strategy.

A More Flexible Collection for Wholesalers

One notable commercial consequence of earlier deadlines and extended manufacturing time frames is the opportunity for brands to sell a complete package to wholesale partners. “In our previous model, a collection was developed, shown and campaigns would follow six months later. This new model enabled us to go to market and to our key wholesale partners with a really cohesive story from product through to marketing — the entire consumer journey,” says Baker.

In one sense, she suggests, fashion immediacy actually offers brands more flexibility. Designers can adapt a collection right up to the point of delivery, thus integrating of-the-moment trends, says Baker, revealing that “30 to 40 percent of products that [Tommy Hilfiger] had in the show were pieces that, after the close of the traditional season, we were able to go back and design and produce and even sell on a fast-track model.”

“We could really see what we were missing, and what consumers were really looking for and interested in. It allowed us to have a more dynamic approach to what would traditionally be pretty locked into that collection otherwise from day one,” she adds.

While critics have suggested that this more responsive design approach leads to increased levels of plagiarism in the industry, it does offer appreciable commercial advantage. “Accounts who wouldn’t normally buy on a

shorter lead-time wanted the pieces that we injected later. They were more interested in the things that felt a little closer to market, a little quicker in terms of the trend,” Baker says.

Coordinating Retail Refreshment for Global Distribution

However, the advantages of being able to tailor collections to more current trends and sell fully realised concepts to wholesalers must be weighed against the operational complexity of consecutively unveiling so-called “See Now, Buy Now” collections across global distribution chains. A business on the scale of Tommy Hilfiger, for example, sells through 20,000 points of sale, in more than 1,500 stores in over 115 countries.⁶⁹

Burberry’s collection was available for purchase immediately after the show from the company’s flagship stores, on its website and at selected wholesale partners including Barneys New York, Colette in Paris and Hong Kong-based travel retailer DFS Group. The show sparked “an instant uplift in sales,” according to Michael Kliger, president of MyTheresa.com.

Though difficult to coordinate across global markets, immediately available product drops can capitalise on buzz in the same manner that cult streetwear brands create when releasing runs of product following their own schedule. “I really believe that the new way to do it is as instantaneously as possible and also packed full of surprises. There has to be excitement, experience and an element of surprise and disruption around it. You can call it fast fashion but [this] is what’s keeping customers excited and engaged,” says Hilfiger.

However maintaining consumer interest in the collection throughout the season requires more forward planning. “One of the things that we did around the last show was to really tackle how can we take this opportunity to create fantastic content that we can then use later in the season, weeks or even a month or two after the show, creating another spike of engagement and interest with our followers,” explains Baker.

To sustain interest in its collection, Hilfiger entered into partnerships with Facebook and Vogue, among others. “[The partnerships] create fresh interest around the show. I think that definitely can and should evolve significantly in the future, to be able to showcase new content linked simultaneously with new product drops,” she continues.

Whether it is possible to maintain margins while keeping fashion’s fussiest consumers excited and engaged by investing heavily in the manipulation of an increasingly complex fashion cycle remains to be seen. But ignoring the tectonic shifts being felt in a marketplace led by ever-demanding consumers — always switched on and expecting brands to constantly stimulate them — carries a significant risk too.

As Bailey says, “Everyone is changing the way they live, work, shop, eat — our industry is not immune to that change, and our customers are not immune to those changes [either].”

8. Organic growth

2017 is expected to be a year of organic growth. Gone are the days of growth driven by store expansion; next year, we should see brands focusing on like-for-like sales, increasing domestic demand, and growing through value rather than volume. Indeed, the “race for space” is long over. The traditional means of fast growth—geographic, channel, and/or store network expansion—have been exhausted, as those few companies still stuck in the old paradigm are discovering to their cost. Further, a decline in retail space productivity and price increases offset by the use of promotions have also been threatening growth. As a result, we believe that in the next year successful companies will be those that focus more tightly than ever on organic growth, particularly through branding and developing their local clientele.

There are several steps involved in this journey. To start, fashion players will redouble their focus on branding in order to escape the increasing commoditisation trap. To create value, brands need to be different and maintain clear, strong brand values. At the luxury end, this brand strengthening in 2017 will likely entail a reinvestment in creativity: creating unique products that encapsulate their USP. At the more affordable

end of fashion, companies can be expected to emphasise their points of distinction by engaging more closely with the customer. Strong brands are also best placed to fight the promotion spiral that leads to a race to the bottom given the perceived negative correlation between the strength of the brand and its share of discounted sales.

Deepening relationships with local clientele also offer an effective way to deal with regional headwinds and—especially for luxury brands—to reduce dependency on tourism, which is susceptible to economic and geopolitical volatility. Cultivating a local clientele can help global fashion players deal with volatility, as they can intensify their focus on one geography during a prosperous time, and shift to another when the first hits a low.

Technology plays a key role in activating brands and clientele. By exploiting developments in upstream technology, particularly predictive analytics, fashion companies can gather and analyse more data to tailor their branding strategy. More practically, this enables them to focus on creating products for their local clientele, including limited-edition and specialised products, with reduced risk of overstock and markdowns.



Q&A

NADJA SWAROVSKI

MEMBER OF THE EXECUTIVE BOARD AT SWAROVSKI

Focused on tech investment and sustainable innovation

“Business models are changing rapidly and we need to move ever faster to provide customers with what they want,” says Nadja Swarovski, a fifth-generation member of the family business who joined in 1995 and repositioned the crystal company into a fashion forward brand. Today she is a member of the executive board at the 120-year old Austrian firm.

Swarovski believes that the adoption of new technology will be “critical” in 2017, in terms of production, marketing, communication, distribution and throughout the retail experience. “We’re committed to ongoing investments in production technology – for example with robotics – to increase speed and flexibility and to ensure competitive manufacturing costs,” she explains.

While the company’s jewellery collections and creative designer collaborations may be front of mind for many consumers, “the core elements of our brand are our technical skills as master cutters and producers of crystal,” says Swarovski. “We not only focus on innovation and evolution but also on reinvention [so] our product development team in Wattens is continually finding new ways to push the boundaries.”

Moving to a flexible global product offering and responding to trends “in real time” will become even more important for product development in the year to come, she suggests. “One of the best examples [from 2016] is from [the launch of] Atelier Swarovski Home. Our Wave Cut technology – which required around 10 years of R&D – debuted with the late Zaha Hadid’s Crista centrepiece. It’s the first time we’ve been able to cut curved forms in crystal.”

“We’re also making investments in our marketing and distribution value chain and our online platforms,” she says, referring to crystals-from-swarovski.com, the firm’s shop-able showcase of partner brand products, featuring items as diverse as stilettos from upmarket European fashion brands to T-shirts from Asian contemporary brands. “Nearly 50% of our traffic now comes from mobile, so continually investing in search is very important,” she adds.

Swarovski is keeping a watchful eye on digital developments and tech advances related to the mobile channel. “[That’s why] we launched our Snapchat channel this year [and] why we’re developing our s-commerce, using tools like the Tapshop visual commerce platform on Instagram to allow followers to shop our feed in a beautiful, seamless manner.”

Besides amplifying the company’s investment in creativity and technology, Swarovski underscores another area of business she has at the forefront of her mind – sustainability. The firm has been monitoring and publishing its sustainability credentials since 2010 and recently embarked on a number of new initiatives. Although she believes that more progress needs to be made across the wider fashion industry, she is hopeful that next year could usher in a more responsible mood.

“Perhaps 2017 will be more about creating an industry of values, especially with so much uncertainty in the world. We understand the importance of creating a positive impact for both people and the planet – and we’re committed to doing so.”

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9. Upstream technology

Placing big bets on technology in 2017⁷⁰ increases a company's chances of being a future winner. Technology investments will have two rationales. First, the clear market trends—cycle acceleration, omnichannel, localisation, and sustainability—pull in different directions: they cannot all be delivered simultaneously without a technological enhancement across the whole value chain. Second, technology will also be seen as the solution to addressing sourcing and supply-chain challenges in an effort to improve margins. Together, these pressures will likely make automation, robotics, and the digital supply chain become more prevalent in the fashion industry. The International Labour Organisation estimates that within a few decades more than half of all salaried workers in emerging countries could be displaced by automation and advanced technologies, and that this disruption will be led by the textiles and clothing industry.⁷¹

Signs of transition to automated processes should already be visible in 2017. Global players have announced large-scale projects, such as the Adidas “speed factory”⁷² and the new Nike distribution centre in Belgium designed around a sustainable supply chain. In 2017, key themes for the fashion industry's digital supply chain are expected to be prototyping, personalisation, end-to-end transparency, and inventory planning. Digitised inventory management and predictive analytics—aligned to investments in CRM—have the potential to allow fashion companies to link inventory around the world to a single

view for the consumer. This in turn makes it possible to sell a product that could have lingered on a shelf to a consumer who wants it halfway around the world. Nonetheless, being too dazzled by data is a danger. If all brands replace the creative process with data analysis to predict what consumers want, a downward spiral in which they create too much of the same product could be difficult to avoid.

The need to adopt a digital process effectively will presumably place added pressure on creatives across all market segments to take up new tools—from virtual design to virtual sampling—to increase efficiency and integrate design-to-cost.

For one set of companies the natural choice will probably be to continue to look for new, cheaper sourcing countries, because their processes are not as sophisticated or they lack the capital to invest in automation and robotics. But others will likely push further into the digital realm.



Adidas' First Speed Factory in Germany
Courtesy

McKinsey Apparel Sourcing Roundtable

DOING MORE WITH LESS — SOLVING TODAY'S APPAREL-SOURCING EQUATION

With fashion companies facing the dilemma of doing more with less, the spotlight is on sourcing companies. The apparel companies, which are their customers, worry about trade agreements, the rising terrorist threat in some of the main sourcing countries, and the amplification of the volatility of sourcing costs by foreign exchange rate effects. At the same time, they have seen labour costs continuing to rise in the main garment-manufacturing countries, energy costs increasing, and raw materials prices creating additional pressure to improve efficiency along the entire value chain, all while options for alternative sourcing countries are running out.

The changing landscape on the demand side amplifies this pressure. The themes of this year and next—from the slowdown in sales to the rise of omnichannel—make it necessary for companies to adapt quickly and move from transactional sourcing to performance-based procurement.

In October, more than 25 apparel sourcing executives and McKinsey experts came together in Hong Kong for the Firm's third annual Apparel Sourcing Roundtable to discuss how they can respond to the challenge by digitising apparel sourcing.

Discussions ranged from procurement digitisation and Industry 4.0 topics on the backdrop of the challenging sourcing environment. Top-of-mind questions for the sourcing industry are how digitisation can drive efficiency and improve service both in procurement and throughout the value chain. The good news is that, as many of the participants agreed, “digital procurement plays into doing more with less”.

Advances in virtual design, digital printing, robotics, and automation are transforming the way companies in many industries design and make their products. Yet, with so much groundwork still to be done in optimising apparel-sourcing processes, the majority of participants felt that the apparel industry is at a very early stage in terms of adopting these approaches.

In light of the high share of manual process management in the industry, even simple automations in the procure-to-pay workflow are viewed as a big step forward. Other relevant initiatives from participating companies include automation in production to increase the “local-for-local” share and drive up flexibility. The executives also cited the potential of the Internet of Things—a network connecting devices, garments with sensors, and advanced analytics—to enable new opportunities to improve planning and processes throughout the apparel value chain. For now, only the more advanced players are even exploring this technology.

Participants in the roundtable clearly see digitising apparel sourcing as a part of the solution to solving today's

sourcing equation of “doing more with less”. However, a survey conducted during the event underlined that their most pressing questions still focus on optimising traditional, non-digitised sourcing to prepare for digital procurement.

Not surprisingly, end-to-end efficiency improvement, corporate social responsibility (CSR), and compliance issues are among the top five topics mentioned. Today's sustainability discussion has widened to include true co-creation of innovations between multiple stakeholders to find circular solutions and to “be in a purpose-driven sourcing situation”, as one participant put it.

Supplier collaboration and development is a main concern for sourcing executives. To secure success over the long run, participants believe that they will need to support suppliers in order to build skills for the digital future.

New skills and knowledge in the product-development and sourcing process will be essential in-house as well. During a discussion on talent, the group recognised, however, that digital know-how alone may not be enough. Instead, the question to be answered in the hiring process is: “Can this leader adeptly navigate the organisation's existing deep culture and processes, and deal patiently with legacy issues while building relationships with others?” This question is becoming even more important as the next generation of sourcing leaders arises, since they have a different perspective on how to grow their careers. Companies need to invest in continuous learning and training as well.

The consensus among the roundtable participants was that apparel sourcing is currently behind in its development compared with other sectors. Only a few companies were mentioned as exhibiting true best practices in moving towards digital procurement.

Pronouncements such as “digitise or die” and “the country of digital procurement is the next sourcing country”—both heard during the conference—may seem like overstatements, especially since true digitisation is a long way off for most sourcing players. However, the participants at the Apparel Sourcing Roundtable were confident that sweeping change is on the way. While few outward signs of digitisation are evident today, many companies are busy laying the groundwork for digital innovation. Those who can make progress quickly—and therefore do more with less—will thrive, rather than just survive the inevitable transformation of sourcing and procurement.

Each year McKinsey & Company hosts the Apparel Sourcing Roundtable to provide sourcing executives with the opportunity for an open exchange about the challenges and opportunities they face.

10. Ownership shake-up

Lastly, we believe the pressures of 2017 may shake up ownership in the fashion industry. On the supply side, many fashion conglomerates are under pressure to perform, and may try to weather the storm by looking more closely at their brand portfolio and divesting non-core brands. This translates to a “powerbrand strategy”, whereby groups look to focus on their performing brands. In 2016, the divestment of individual brands became apparent with the sale of Donna Karan by LVMH.⁷³ As the first divestment by the group since 2005, it opened the door to further reorganisation within large conglomerates in future. The move to sell underperformers would allow these organisations to focus their attention on further propelling their better-performing brands, particularly the luxury segment, which commands higher margins.

While the supply of investment opportunities in fashion is increasing, so is demand. The private equity (PE) industry is facing its own pressures, particularly to deploy money. As of June 2016, according to the research firm Preqin, firms had a record \$818 billion in “dry powder”—committed capital yet to be invested.⁷⁴ Over the

past few years various PE firms have gained experience in the fashion industry, including KKR with SMCP, Permira with Valentino, Clessidra with Cavalli, Carlyle with Moncler, and Blackstone with Versace.⁷⁵ Available capital, coupled with experience and success cases in the fashion industry over the past couple of years, means that private equity should have the capacity to take on the increasing number of brands that require investment and professionalisation.

The fashion industry also presents an interesting set of investment targets in 2017. While luxury is largely concentrated in the conglomerates, there are opportunities in the affordable luxury and premium / bridge space. As evidenced by the McKinsey Global Fashion Index, this space is fragmented and operating profit performance ranges widely between the best and worst-performing companies. Nonetheless, both affordable and premium are fast-growing segments with emerging brands. Therefore, two major trends are likely to emerge among investors: the first is finding tired or poorly operated, poorly managed brands to turn around; the other is finding brands that are scalable.

PRIVATE
EQUITY



Q&A

DANIEL LALONDE

PRESIDENT AND CHIEF EXECUTIVE OFFICER OF SMCP

More private equity transactions to come

“Agility is the key for next year,” declares Daniel Lalonde, president and chief executive of SMCP, the French group that owns affordable luxury brands Sandro, Maje and Claudie Pierlot. “It’s about agility in keeping the consumer excited; agility providing the relevant product offer fast; and agility interacting with a very connected customer who is also very channel-agnostic.”

Lalonde cites an increasingly smart and savvy consumer as the main driver for this. “The overall sophistication of the customer has increased rapidly last year and it’ll be a theme for the next years as well. They’re very smart and they’re very comfortable moving between different segments, categories, channels, brands and geographies.”

“It’s a more modern way of consumption that we’re seeing than in the past... Consumers make trade-offs to consider what is the best value.”

In a flat market, the company posted a 19.2 percent rise in sales for the first half of 2016, driven by strong demand for all of its brands across its regions. Last year marked a milestone for SMCP, as it was the first time that total international sales outweighed sales generated in the French home market. “We have a very, very clear ambition and a very clear strategy that everyone in the company knows and it’s quite simple. We want to be the global leader in accessible luxury,” he says.

“[We also have] a very clear direction on where we’re going, how we’re going to fund the growth and we have a very granular plan even on, for example, new store openings. I can tell you in the next three years exactly where we are opening what store, in what city and in what mall. [But] I’d say our secret sauce is our business model [which] is unique in two ways: we’re retail pure players and we blend the codes of luxury and fast fashion.”

“We’re allergic to the traditional way of doing wholesale,” he explains, “Ninety-four per cent of our business is done through direct retail [and] there are

big, big advantages of being a retail pure player today. You control your distribution, you control your commercial policy, you can replenish the stores quickly. We know what sells right away... It’s also great for omnichannel because I can tie all my stores together.”

In March, one of China’s largest textile producers, Shandong Ruyi, bought a majority stake in SMCP from private equity (PE) firm Kohlberg Kravis Roberts & Company (KKR), which had acquired a majority stake in the company three years earlier.

“For us, it has been a very good period with KKR bringing in their knowledge. They know what they know; they know what they don’t know; and I think it’s been a very good partnership. They’ve certainly added value, [especially] with the management and our international expansion, so it’s been very positive.”

“This myth of PE companies coming in and driving — well, they do drive performance, there’s no doubt about that, but with a mindset of long-term value creation and taking the right decisions and the right investments for the brands for the long-term. So it’s not been short-term thinking and decision-making. [In my experience], PE firms can be very performance-driven, priority-driven and they’re great sparring partners for CEOs.”

However, Lalonde concedes that not all private equity firms are interested in the long-term health and desirability of the fashion brands they acquire. “It depends,” he says. “Not all PE companies are the same. Some have more success and more experience in turnarounds and others more in taking a company up to the next level.”

Lalonde believes that despite the increased volatility facing the fashion industry next year, private equity houses will continue to acquire fashion brands in 2017. “Listen, on the PE side of M&A... there will be a continuation of activity,” he says. “They have the resources and I think they’ve developed solid experiences now.”

“So it’s not been short-term thinking and decision-making. PE firms can be very performance-driven, priority-driven and they’re great sparring partners for CEOs.”

GLOSSARY

Athleisure

Athletic-inspired way of dressing rooted in joggers, leggings, tank tops, and sneakers—designed to be worn for exercising, streetwear, and daywear.

Baby boomers

Demographic cohort born in the years following the Second World War (approximately 1946–64), when there was a temporary marked increase in the birth rate.

Compound Annual Growth Rate (CAGR)

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

Casualisation

Consumer trend reflecting the adoption of casual wear in more and more non-casual settings.

Customer relationship management (CRM)

A strategy for managing all your company's relationships and interactions with existing and potential customers.

EBITA

Operating profit measure—Earnings Before Interest, Taxes, and Amortisation. It is a financial indicator used widely as a measure of efficiency and profitability of businesses.

Economic profit

Measure for value add created by businesses, whereby opportunity costs are deducted from revenues earned. This measure takes into consideration explicit costs and implicit costs, while operating profit reported in accounts only utilises explicit costs. Economic profit is defined as invested capital times the difference of ROIC (see below) minus WACC (see below).

Fashion Cycle

The process by which a given collection goes through the value chain (from design to sell-out). Can also refer generally to the life cycle of a fashion trend.

FashionScope

Proprietary McKinsey tool that builds on CityScope data to forecast market sizes of the leading fashion categories based on their respective unique identified drivers in the 2,600 largest cities on the globe.

Gross Domestic Product (GDP)

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

Genderless

(synonyms: unisex, genderneutral) Fashion designed to be suitable for both sexes in order to live individual life choices unimpeded by mainstream gender norms of society.

Generation X (Gen X)

Following the baby boomers and preceding Generation Y (born circa 1965–81).

Generation Y (Gen Y/Millennials)

Demographic cohort born circa 1982–99. The name is based on Generation X, the generation that preceded them.

Invested Capital

Sum of all cash that has been invested in a company over its life without regard to financing form or accounting name. It is the total of investments in a business from which operating revenue is derived.

McKinsey CityScope

McKinsey advanced econometric analytics to identify the specific economic and demographic drivers of market growth. Based on a unique Cityscope database of ~2,600 cities worldwide and 2025 projections of over ten demographic and economic drivers, at country and city level.

McKinsey Global Fashion Index (MGFI)

Proprietary and copyrighted McKinsey tool that provides a global and holistic industry benchmark for the entire fashion industry—from luxury to discount players. It is focused on the financial metrics of fashion companies across all geographies, business models, and product categories.

McKinsey Global Institute (MGI)

Business and economics research arm of McKinsey, established in 1990 to develop a deeper understanding of the evolving global economy. MGI's mission is to provide leaders in the commercial, public, and social sectors with the facts and insights on which to base management and policy decision.

Millennials

See Generation Y.

Modest wear

Fashion that complies with Islamic interpretations of modesty and ethics in design, production, and presentation. General representation includes loose clothing and covering of the body according to religious principles.

Omnichannel

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

Plus-size

Term for clothing proportioned specifically for people whose bodies are larger than the average person's. The application of the term varies from country to country.

Pure-play

Company that focuses exclusively on a particular product or service. In fashion, it usually refers to companies that operate only on the Internet.

Ready-to-Wear

Garments or footwear produced toward standardised measurements in mass production and sold through retail stores rather than made to measure for an individual customer.

Return on Invested Capital (ROIC)

Percentage amount that a company is making for every percentage point over the actual cost of capital (WACC). It is an indicator of how well a company is using its money to generate returns.

Sales

Reported net sales (net of excise duty). Sales growth is shown at nominal values and at fixed 2015 exchange rates.

See-Now, Buy-Now

Shoppable runway shows that allow consumers to buy their collections immediately after they debut on the catwalk.

Stock-Keeping Unit (SKU)

Specific item of merchandise stored to a specific location. The SKU is intended as the most disaggregated level when dealing with inventory.

Unique Selling Proposition (USP)

Real or perceived benefit of a good or service that differentiates it from competing products or services and gives its customers a tangible or intangible reason to prefer it over other products or services.

Weighted Average Cost of Capital (WACC) Calculation of a firm's cost of capital in which each category of capital is proportionately weighted. It is the rate that a company is expected to pay on average to all its debtors.

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CONTACTS



23-31 GREAT TITCHFIELD STREET
6TH FLOOR
LONDON W1W 7PA

editor@businessoffashion.com
www.businessoffashion.com

McKinsey&Company

For any questions on the report or further discussion, please contact a member of McKinsey's Apparel, Fashion & Luxury global leadership team:

ANTONIO ACHILLE
SENIOR PARTNER, MILAN

Antonio.Achille@mckinsey.com

ACHIM BERG
SENIOR PARTNER, FRANKFURT

Achim_Berg@mckinsey.com

LEONIE BRANTBERG
ASSOCIATE PARTNER, LONDON

Leonie_Brantberg@mckinsey.com

AIMEE KIM
SENIOR PARTNER, SEOUL

Aimee_Kim@mckinsey.com

NATHALIE REMY
PARTNER, PARIS

Nathalie_Remy@mckinsey.com

JENNIFER SCHMIDT
PARTNER, NEW YORK

Jennifer_Schmidt@mckinsey.com

KATE SMAJE
SENIOR PARTNER, LONDON

Kate_Smaje@mckinsey.com

NAOYUKI IWATANI
SENIOR PARTNER, TOKYO

Naoyuki_Iwatani@mckinsey.com

BILL RUSSO
SENIOR PARTNER, NAIROBI

Bill_Russo@mckinsey.com

SAHANA SARMA
PARTNER, MUMBAI

Sahana_Sarma@mckinsey.com

FÁBIO STUL
SENIOR PARTNER, SAO PAULO

Fabio_Stul@mckinsey.com

