

The State of Fashion 2023



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The State of Fashion 2023

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GLOBAL
ECONOMY

CONSUMER
SHIFTS

FASHION
SYSTEM

MGFI

LUXURY
2023

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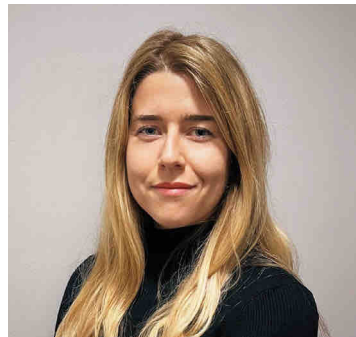
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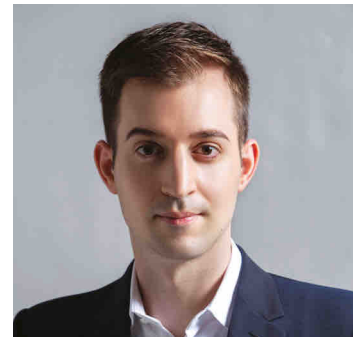
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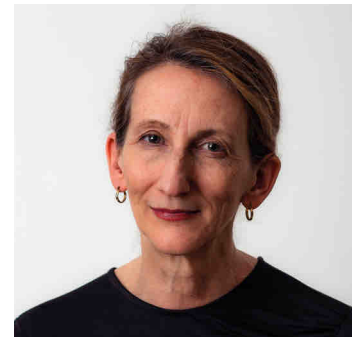
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EXECUTIVE SUMMARY

Resilience in the Face of Uncertainty

Just as the fashion industry was beginning to find its feet after Covid-19's turmoil, the later months of 2022 seem determined to throw brands and retailers off course again. Deteriorating macroeconomic and geopolitical conditions have weighed heavily on the industry in the second half of the year and continue to leave fashion executives on edge as they look towards 2023.

However, much of the industry is entering this difficult period with strong foundations, having experienced impressive growth in 2021 and in the first half of 2022. As economies around the world began lifting restrictions in 2021 after enduring the pandemic's devastation, the fashion industry benefitted from a burst of pent-up consumer demand, despite some challenges remaining, like supply chain disruptions. Global industry revenues in 2021 grew 21 percent year on year, while the average EBITA margin close to doubled, growing 6 percentage points. The industry continued its strong performance in early 2022, with 13 percent revenue growth in the first half of the year.

More than 50 percent of the companies tracked by the McKinsey Global Fashion Index contributed to the industry's total economic profit in 2021, compared to just 32 percent in 2020. The proportion of value destroyers (companies generating negative economic profit) has thus fallen to its lowest since 2013. Our roster of fashion "Super Winners" — the top 20 listed companies by economic profit — comprises many of the usual suspects from the luxury and sportswear categories, while players in the discount segment have also climbed up the list.

But some of these gains were chipped away as 2022 progressed. The war in Ukraine, which started in February, triggered a string of events, including an escalating energy crisis across Europe. Troublesome inflation in many major economies led central banks to roll out back-to-back interest rate hikes, ending a lengthy period of ultra-low and even negative rates, in a bid to temper rising prices and help steer economies away from recession.

Looking ahead to 2023, the drivers contributing to a broad state of global fragility are top of mind for fashion executives. In the BoF-McKinsey State of Fashion 2023 Survey, 85 percent of fashion executives predict inflation will continue to challenge the market next year. Meanwhile, geopolitical tensions, specifically around the ongoing war in Ukraine, have disrupted supply chains and created an energy crisis that 58 percent of executives also believe will weaken the fashion market.

In aggregate, McKinsey expects global fashion sales growth of 5 percent to 10 percent for luxury, and negative 2 percent to positive 3 percent for the rest of the industry in 2023, while the dichotomies that previously defined the fashion business are expected to return. Beyond the differences between luxury and players from other segments, regional differences will be pronounced. The US economy, despite the slowdown, is expected to be more robust than other major global economies — Covid-19 outbreaks and precautions continue in China, while Europe suffers from an energy crisis and a weakened euro against a strong US dollar.

Against this backdrop, the world map for industry

growth is shifting. Markets that once showed solid growth potential are now facing a wider range of risks than they once did, ranging from extreme weather conditions to political or social unrest. Other regions such as the Middle East may become new havens of growth, requiring brands to further localise designs, marketing and merchandising to attract new customers. But as fashion executives assess what the new regional realities mean for their businesses, their scenario planning will need to factor in more than financial risks and opportunities.

Fashion companies will need to rethink their operations. Many will update their organisational structures, introducing new roles or elevating existing ones to target key growth opportunities and respond more effectively to risk. Brands may also choose to see the next year as a time to team up with manufacturing partners to sharpen their supply chain strategies. This may involve nearshoring to better respond to fast-shifting consumer demand or leaning more heavily on data analytics and technology to manage inventory efficiently.

Distribution channel mixes are also ripe for reassessment. As e-commerce growth normalises after its pandemic boom, the sheen has started to wear off the direct-to-consumer digital model that propelled many brands over the past decade. As lockdown restrictions lifted, shoppers have made it clear that although they still value online channels — particularly within luxury, where online DTC and third-party platforms will continue to drive growth — shoppers also want brick-and-mortar experiences. Brands will also need to factor in the continued return of international travel to pre-pandemic rates, which will be buoyed by a strong US dollar. Wholesale and physical retail have a new role in revamping customer journeys, requiring brands to look beyond tier-one cities to be physically closer to consumers.

Brands will have to work hard to remain attractive to consumers, given the tough economic environment. Consumer behaviours in 2023 will depend greatly on household incomes. While higher-income households will be less affected by economic pressures and look likely to continue shopping for luxury goods, as in previous downturns, lower-income households will likely cut back or even eliminate discretionary spending, including apparel. Some will trade down, pivoting to value retailers,

marked-down items and off-price channels while eschewing full price, premium and mass brands.

All this elevates the importance of brands' marketing strategies. Brands should use the year ahead to innovate their digital marketing. Budgets will shift to alternative channels that could generate better return on investment than paid social media ads, such retail media networks, while building stronger brand communities. This will feed into distribution channels, as brands will need to seek higher margins and gather more first-party customer data.

How brands manage and communicate about issues that are important to consumers will also be critical. Consider sustainability. New and emerging regulations along with heightened consumer awareness of fashion's contribution to the climate crisis mean that brands will need to be hyper-vigilant about how they talk about their sustainability-related initiatives and achievements to ensure they are not "greenwashing," which could potentially lead to reputational damage or costly fines.

Executives are bracing for a tough 2023; leading brands will deploy realistic but bold strategies that combine careful cost control with strategic investments in skills growth.

Brands that effectively navigate industry challenges in 2023 will be better positioned to seize consumer trends. Coming out of the pandemic, formal dress codes remain disrupted, pushing brands to rethink office and special occasion attire. Meanwhile, consumers are increasingly shopping across gender categories, and brands that can adapt their merchandising strategies accordingly will be able to strengthen their relationships with a wider range of consumers.

Executives are bracing for a tough 2023; leading brands will deploy realistic but bold strategies that combine careful cost control with strategic investments in skills growth. Those that recognise that growth will be unpredictable or muted, but still charge forward with investments in innovation throughout their organisations, will find they are in a stronger position to accelerate their businesses when the uncertainty and fragility subside.



Preparing for a Global Slowdown

The global fashion industry sharply rebounded in 2021 and much of 2022. But in today's fragile market, expectations of a continued recovery can downshift quickly. Fashion executives are largely pessimistic about the year ahead, anticipating that a number of challenges will negatively impact their businesses and customers.

In the BoF-McKinsey State of Fashion 2023 Survey, 84 percent of industry leaders said they expect market conditions to decline or stay the same in 2023.¹ The response stands in stark contrast to the cautious optimism the cohort felt heading into 2022, when 91 percent of executives predicted market conditions would improve or remain the same.²

The effects of inflation are weighing heavy on executives as they look to 2023. With prices in Europe and the US reaching historic highs in late 2022 and central banks raising interest rates, consumer demand is expected to suffer. Inflation is also pressuring brands' costs, as the industry encounters a competitive labour market and the consequences of climbing energy prices.

Beyond inflation, surveyed fashion executives identified a range of concerns that had not impacted the industry for the better part of a decade. In the year ahead, industry leaders are worried about geopolitical instability and conflict, supply chain disruptions, increased economic volatility, and rising energy prices.

Regarding geopolitical tensions,

respondents specifically referenced the war in Ukraine that began in February 2022. At the same time, only 5 percent of executives listed Covid-19 among their top three concerns in 2023, demonstrating the public health crisis has been eclipsed by economic and geopolitical issues.³

Outlooks for 2023 vary by region and continent, however. In the US, which is more insulated from the effects of the war in Ukraine and Covid-19, 61 percent of executives expected the same or better conditions in 2023 than 2022.⁴ European and Asian fashion leaders were the most pessimistic, with 64 percent and 53 percent anticipating worsening conditions, respectively.⁵

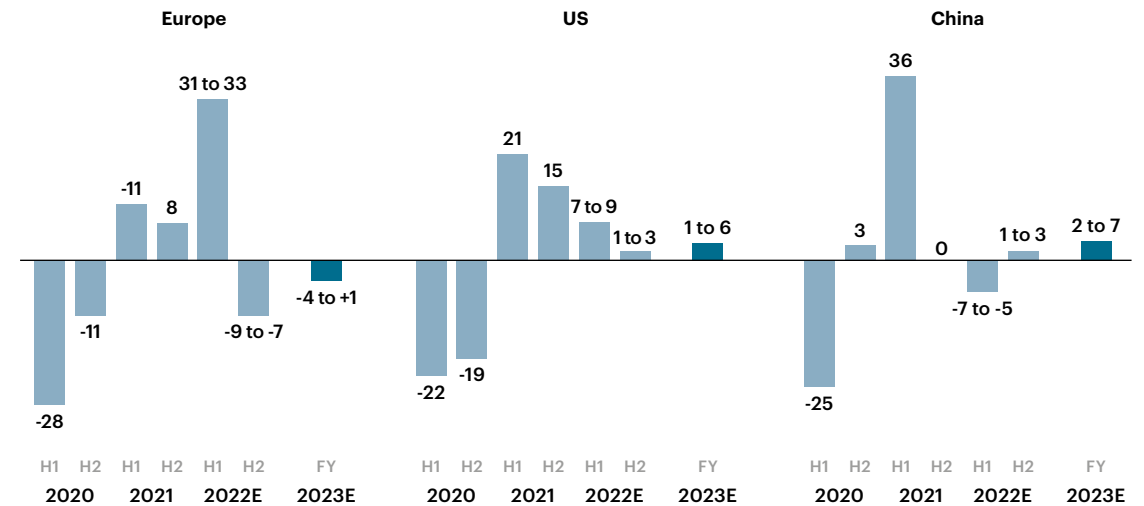
The sober outlooks are warranted. In 2023, the industry's sales are expected to grow at a slower rate than in 2022, when the gains from the first half of 2022 were largely diminished by the deceleration in spending in the second half. Industry growth figures in 2023 will also be distorted by inflation, with a significant share of sales affected by rising costs and prices. In this context, 2023 could witness year-on-year volume declines, which has not happened for many years.

The luxury segment should show more resilience in the months ahead than other categories. Its sales are projected to grow 1 percent to 3 percent in the second half of 2022 and 5 percent to 10 percent in 2023, based on McKinsey Fashion Growth Forecasts. For the rest of the industry, growth in 2023 looks likely to be flat or

Exhibit 1:

Fashion sales in 2023 are expected to grow in the US and China

Non-luxury fashion retail sales, year-on-year growth, 2020-2023E, %



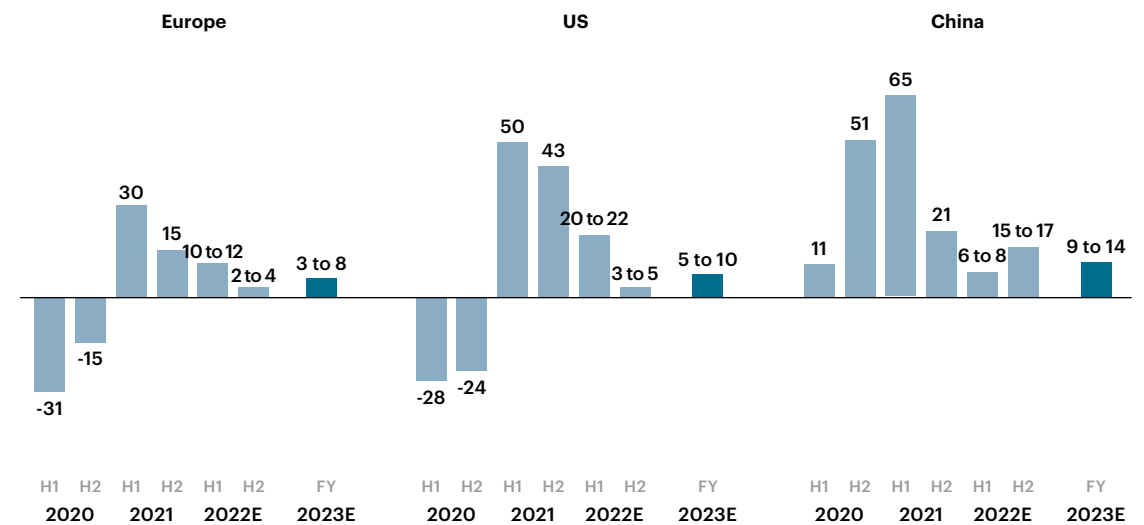
Note: Growth forecasts reflective of inflation; growth rates calculated on actuals expressed in local currencies

Source: McKinsey Fashion Forecasts; McKinsey analysis; expert interviews

Exhibit 2:

Luxury fashion sales are expected to grow across the board in 2023

Luxury fashion retail sales, year-on-year growth, 2020-2023E, %



Note: Growth forecasts reflective of inflation; growth rates calculated on actuals expressed in local currencies

Source: McKinsey Fashion Forecasts; McKinsey analysis; expert interviews

INDUSTRY OUTLOOK

even negative.⁶ While the industry is expected to contract between 5 percent and 7 percent in the second half of 2022, it should see slight improvements in 2023, with growth projected between negative 2 percent and positive 3 percent.⁷

European prospects in 2023 are particularly gloomy. Europe's GDP is expected to grow by less than 1 percent in 2023,⁸ and inflation is expected to remain high, undermining consumer confidence, which is already at levels as low as 2020. McKinsey's Quarterly Consumer Pulse Survey found 14 percent of Europeans were optimistic about their country's economic recovery in the second quarter of 2022,⁹ compared to 15 percent during the same period in 2020.¹⁰

Non-luxury fashion sales in Europe are forecast to grow between negative 4 percent and positive 1 percent.¹¹ And apparel and footwear will likely continue to lose wallet share among many consumers who are feeling the pinch of high petrol and energy prices and the tapering of pandemic-era government support programmes. Luxury will remain an exception in the region as wealthy consumers and tourists from the US and Middle East will be less affected by inflation. European sales for the sector are projected to grow 3 percent to 8 percent in 2023.¹²

The US fashion industry's growth will also likely slow, but might show greater resilience than Europe. The already-strong US dollar is likely to peak in the first half of 2023, and inflation is projected to cool by the second half. GDP in 2023 is forecast to grow 1.5 percent, down from 3 percent in 2022.¹³ Non-luxury fashion companies are expected to grow modestly in 2023, between 1 percent and 6 percent, continuing the trend observed in the second half of 2022. Like the rest of the luxury industry, US luxury companies should outperform other categories in the country, with forecasted growth of 5 percent to 10 percent.¹⁴ Travel will be a driver for the industry. Domestic leisure travel spending has already surpassed pre-pandemic levels and business travel is projected to recover to 96 percent of its pre-pandemic levels in 2023.¹⁵

China is expected to see a modest recovery in 2023 after a difficult 2022, when persistent coronavirus outbreaks and a real estate crisis undermined the fashion market. The country's performance in 2023 will be heavily correlated to GDP, which is forecast to grow between 5 percent and 7 percent.¹⁶ Non-luxury sales are projected to end 2022 with limited growth of 1 percent to 3 percent in the second half but are forecast to deliver 2 percent to 7 percent growth in 2023.¹⁷ After moderate growth in the first half of 2022, China's luxury market should grow 15 percent to 17 percent year on year in the second half, and 9 percent to 14 percent in 2023. The country's fashion industry performance at the end of 2022 and through 2023 will be heavily dependent on Covid-19 outbreaks and health precautions. China's substantial middle class will also be highly impacted by policy responses to the real estate crisis and international travel guidelines.

Strategic Actions

The majority of fashion leaders polled for the BoF-McKinsey State of Fashion 2023 Survey said they plan to focus on sales growth in the year ahead. But amid worsening economic conditions, 37 percent also said they plan to seek cost improvements. This marks the highest number of respondents looking to cut or better manage costs since The State of Fashion executive surveys began in 2016.

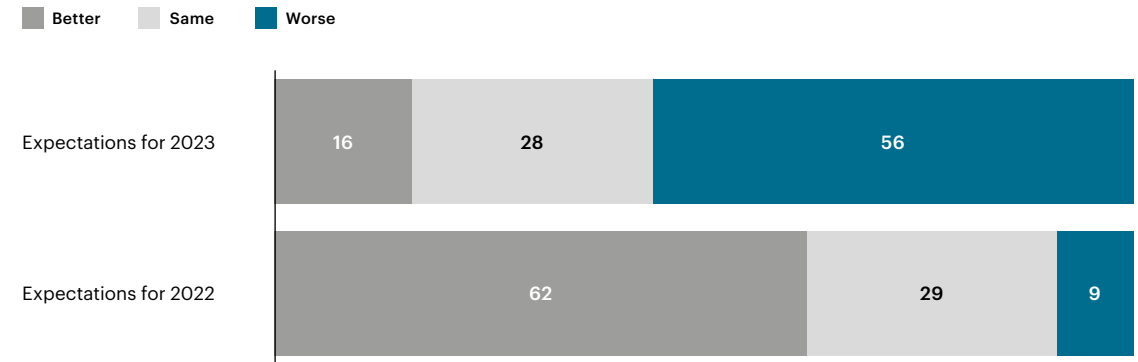
This comes as many of their biggest line-item costs are rising. More than 97 percent of respondents said they anticipate higher cost of goods sold as well as selling, general and administrative expenses in 2023. More than 50 percent of executives expect COGS to increase by over 5 percent, while 40 percent also expect SG&A to increase by over 5 percent. Furthermore, a higher number of leaders are planning to streamline their businesses in the year ahead than they were in late 2020 during the pandemic.¹⁸

To protect margins, nearly three-quarters of executives stated that they plan to increase the

Exhibit 3:

Fashion executives are more pessimistic in 2022 than in 2021 about the conditions the industry faces in the year ahead

Expectations for how fashion industry conditions will evolve in the year ahead,*
% of respondents



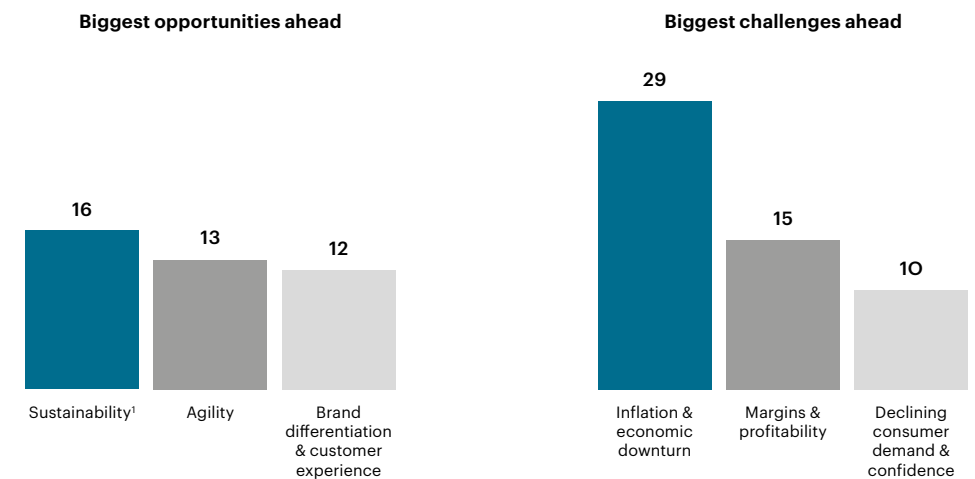
* Compared to current year

Source: BoF-McKinsey State of Fashion 2023 Survey, BoF-McKinsey State of Fashion 2022 Survey

Exhibit 4:

Sustainability presents the biggest opportunity and inflation the greatest threat to the fashion industry in 2023

Top three opportunities and challenges,
% of respondents



¹ Also mentioned as a top industry challenge or opportunity in The State of Fashion 2022

Source: BoF-McKinsey State of Fashion 2023 Survey

INDUSTRY OUTLOOK

prices of their products. Among respondents, 10 percent foresee price hikes of more than 10 percent.

To help mitigate the impacts of inflation on cost, over 60 percent of executives said they plan to optimise or re-negotiate sourcing agreements. In addition, approximately two-thirds of executives said they are considering nearshoring (moving production closer to their home markets) to adapt to unpredictable consumer demand. More than 60 percent of fashion leaders also said they were considering strategic partnerships with suppliers to increase their speed to market and create more efficient supply chains that will carry benefits for their businesses over the long term.

To reduce their own costs of inventory management and simplify sourcing agreements, nearly 75 percent of respondents aim to simplify inventory by reducing the number of products and styles, while 65 percent plan to adjust the balance between seasonal and basic items in assortments. Many fashion leaders are also anticipating customers will trade down to value products. As such, nearly 60 percent of respondents plan to increase the share of lower-priced items in their assortments, while 80 percent expect more than 10 percent of their sales in 2023 to be driven by promotions and discounts.

Growth Priorities

In 2023, fashion leaders anticipate a continuation of the casualisation trend that took hold during the pandemic as more shoppers shifted to working from home. Casualwear, followed by sportswear and sneakers, are the highest-ranking categories in terms of where executives see the greatest growth potential. Accessories, jewellery and formal shoes ranked lowest, reflecting expectations that consumers will cut spending on non-essential items during the period of economic uncertainty. However, while executives believe consumers will continue dressing casually in their day-to-day, nearly 40 percent expect occasion wear to be one of their top three growth categories in 2023, as special

events like weddings increase after having been postponed during the pandemic.

While executives are divided on how long the economic slowdown might last, they agree the conditions ahead will be difficult for the industry to navigate.

Despite the economic challenges ahead, some fashion executives said they remain focused on sustainability projects, which was cited as the most important opportunity for 2023 by 16 percent. Meanwhile, only 3 percent of respondents listed web3 as a top theme shaping 2023 and only 8 percent said it had been a major consideration for 2022. While metaverse-related initiatives will likely play a growing role in the industry in years to come, for now it is a nascent opportunity. Executives are more focused on addressing near-term challenges to their businesses.

As they consider where to invest in global markets, fashion executives cited the Middle East, North America and Asia Pacific (excluding China and India) as the most promising regions for 2023 compared to 2022. In line with more optimistic expectations in these regions, they were also among the top choices for respondents planning to increase their footprints in 2023.

While executives are divided on how long the economic slowdown might last, they agree the conditions ahead will be difficult for the industry to navigate. In addition to concerns about inflation, economic slowdowns and margin pressures, respondents cited changing consumer demand and declining confidence as key challenges in 2023.

All told, the state of the global fashion industry in 2023 will be characterised by a sober world that is unpredictable and fragile. Fashion leaders will be challenged to streamline costs, quickly sharpen their risk management strategies and modernise their operations to build resilience amid a tumultuous time ahead.



Shopper browsing apparel in a store. Thomas Barwick/ Getty Images.

The State of Fashion 2023

GLOBAL ECONOMY

01.

Global Fragility

Amid the highest inflation in a generation, rising geopolitical tensions, climate crises and sinking consumer confidence in anticipation of an economic downturn, the global economy is in a volatile state. Fashion brands will need careful planning to navigate the many uncertainties and recessionary risks that lie ahead in 2023.



56% of fashion executives expect conditions in the fashion industry to worsen in the year ahead

02.

Regional Realities

Understanding where to invest globally has never been easy but rising geopolitical uncertainty and uneven post-pandemic economic recoveries, among other factors, will likely make it even more challenging in 2023. Brands can re-evaluate regional growth priorities and hone their strategies so they are more tailored to the geographies in which they operate.



~1/2 of fashion executives expect to expand their footprint in North America in 2023

CONSUMER SHIFTS

03.

Two-Track Spending

Consumers may be impacted differently by the potential economic turbulence in 2023. Depending on factors including disposable income levels, some will postpone or curtail discretionary purchases; others will seek out bargains, increasing demand for resale, rental and off-price. Fashion executives should adapt their business models to protect customer loyalty and avoid diluting their brands.



74% of US fashion consumers traded down to less expensive brands or products between April and July 2022

04.

Fluid Fashion

Gender-fluid fashion is gaining greater traction amid changing consumer attitudes towards gender identity and expression. For many brands and retailers, the blurring of the lines between menswear and womenswear will require rethinking their product design, marketing, and in-store and digital shopping experiences.



1 in 2 Gen-Z consumers on average have purchased fashion outside of their gender identity

05.

Formalwear Reinvented

Formal attire is taking on new definitions as shoppers rethink how they dress for work, weddings and other special occasions. While offices and events will likely become more casual, special occasions may be dominated by statement-making outfits that consumers rent or buy to stand out when they do decide to dress up.



39% of fashion executives expect occasion wear to be among the categories to grow the most in 2023

FASHION SYSTEM

06.

DTC Reckoning

Though brands across price segments and categories have embraced digital direct-to-consumer channels, mounting digital marketing costs and e-commerce readjustments have put the viability of the DTC model into question. To grow, brands will likely need to diversify their channel mix, including wholesale and third-party marketplaces, alongside DTC.

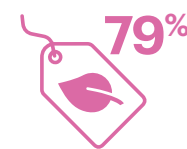


1/3 of fashion executives cited challenges to direct-to-consumer channels as one of the top themes that will impact their business in 2023

07.

Tackling Greenwashing

As the industry continues to grapple with its damaging environmental and social impact, consumers, regulators and other stakeholders may increasingly scrutinise how brands communicate about their sustainability credentials. If brands are to avoid "greenwashing," they must show that they are making meaningful and credible change while abiding by emerging regulatory requirements.

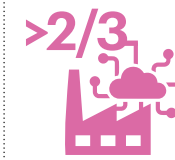


79% of fashion executives consider the lack of standards to assess sustainability performance as the greatest hurdle to improving how consumers perceive their sustainability efforts

08.

Future-Proofing Manufacturing

Continued disruptions in supply chains are a catalyst for a reconfiguration of global production. Textile manufacturers can create new supply chain models based around vertical integration, nearshoring and small-batch production, enabled by enhanced digitisation.



>2/3 of apparel chief purchasing officers expect digitisation to be the most important capability for suppliers to grow in the year ahead

09.

Digital Marketing Reloaded

Recent data rules are spurring a new chapter for digital marketing as customer targeting becomes less effective and more costly. Brands will embrace creative campaigns and new channels such as retail media networks and the metaverse to achieve greater ROI on marketing spend and gather valuable first-party data that can be leveraged to deepen customer relationships.



79% of US apparel and footwear executives rate the performance of retail media networks as better than other marketing channels

10.

Organisation Overhaul

Successful execution of strategies in 2023 will in part hinge on a company's alignment around key functions. Fashion executives need a new vision for what the organisation of the future will require, focusing on attracting and retaining top talent, as well as elevating teams and critical C-suite roles to execute on priorities like sustainability and digital acceleration.



90% of fashion executives have projected a skills shortage in their organisations

GLOBAL ECONOMY

01. GLOBAL FRAGILITY

02. REGIONAL REALITIES



01. GLOBAL FRAGILITY

Amid the highest inflation in a generation, rising geopolitical tensions, climate crises and sinking consumer confidence in anticipation of an economic downturn, the global economy is in a volatile state. Fashion brands will need careful planning to navigate the many uncertainties and recessionary risks that lie ahead in 2023.

KEY INSIGHTS

1. A range of destabilising factors, such as inflation and heightened geopolitical tensions, continue to weaken an already fragile world economy, with global GDP growth expected to fall to approximately 2.5 percent in 2023 as the threat of recession looms over many countries.
2. Consumers are becoming more cautious about their discretionary spending in most regions. Europeans intend to make the biggest spending cuts on apparel, footwear, and accessories and jewellery.
3. To protect their companies' bottom lines, 72 percent of fashion executives plan to increase prices and 37 percent expect to focus on cost improvements in 2023, a higher proportion than in 2020.

EXECUTIVE PRIORITIES

Broaden scenario planning

While executives should identify non-negotiable objectives, their scenarios should capture the full range of economic and political outcomes and contain flexible contingency plans.

Build pricing muscle

Build greater pricing capabilities to adapt to a high-inflation environment and protect top lines, crafting bespoke pricing strategies that account for fluctuations in customer purchasing power and maximise impact across the assortment.

Hone profitability

With supply of capital tight, leaders will need to focus on the bottom line and consider making difficult trade-offs in inventory and supply chain management to prioritise profitability over revenue and market share.

If any questions remained as to how interconnected the global economy has become, 2022 provided clear answers. By the end of the year, few economies were spared from the effects of escalations in everything from inflation to global supply chain meltdowns to heightened geopolitical tensions, all amid a worsening climate crisis that has contributed to unprecedented environmental events, from droughts to floods to heat waves. None of this looks likely to disappear entirely in 2023.

The impact on the global economy is already evident: the strong GDP growth of 6.1 percent recorded in 2021¹⁹ will likely slip below 3 percent in 2022 and to approximately 2.5 percent in 2023.²⁰ The uncertainty around these outcomes remains very high, reflecting the ongoing volatility of the global economy.²¹

In the year ahead, business planning across the fashion industry must reflect this new state of fragility. In this environment, scenario and contingency planning becomes even more critical as companies must understand whether the range of potential outcomes will require tactical changes in their operating plans in the next one to two years to mitigate risks and seize hidden opportunities. Business leaders must ask whether this potential range of outcomes changes their view on the fashion industry market segments within which they operate and what their medium- and long-term strategies should be.

Shocks Spill Over into 2023

Several events in 2022 will continue to shape 2023. Russia’s invasion of Ukraine has first and foremost created a humanitarian crisis. It has also severely disrupted global commodity markets, catapulting Europe into a severe energy squeeze and causing many developed and developing economies to struggle with significantly high prices for basic food imports.^{22,23} In Germany, the euro zone’s largest economy, the annual increase of food prices reached close to 15 percent in July²⁴ and energy

costs are expected to triple from 2023,²⁵ shrinking consumers’ budgets for discretionary goods like fashion.

By contrast, the financial boost from gas and oil exports is evident in countries such as Saudi Arabia, where the economy is expected to grow at its fastest pace in a decade in 2022 with GDP expanding by 7.6 percent, creating opportunities for the fashion industry.²⁶

While Covid-19 has mostly faded from news headlines in some countries, it continues to cause a significant health and economic impact in others. Nevertheless, during 2022 most governments rolled back Covid-19 public health restrictions as well as pandemic-related household and business aid packages, from tax and other relief for US households to cash handouts in Japan to loan guarantees in South Africa.²⁷ China is a notable exception; new Covid-19 variants and outbreaks are being met with strict lockdown periods that continue to raise concerns about the country’s growth trajectory in the short term.²⁸

Price hikes are expected to continue into 2023 as brands pass on increased costs to customers.

In the US and Europe, the effects of inflation are already apparent in fashion. Prices for apparel for sale online across the US, UK, France, Italy and Spain increased 22 percent between July and October 2022 compared to between March and June 2022.²⁹ Price hikes are expected to continue into 2023 as brands pass on increased costs to customers. Inflation could impact fashion companies in other ways, including higher costs of borrowing, potentially causing planned investments or growth strategies to be delayed or scaled back.

To help curb inflation, the US Federal Reserve, the European Central Bank and other central banks have been aggressively raising

interest rates — after negative or ultra-low levels for several years in many countries³⁰ — bringing what Jerome Powell, head of the US Federal Reserve, described as further “pain to households and businesses” as part of the “unfortunate costs of reducing inflation.”³¹

Here too, China is an exception; a slowing property market in the country prompted the People’s Bank of China to lower key interest rates in August 2022 after total credit extended to the economy hit record lows in the previous month.³²

In the US, many economy watchers believe that a recession is increasingly likely in 2023,^{33,34} while the Bank of England warned in September 2022 that Britain’s economy may already be in recession, following forecasts of GDP contraction over two consecutive quarters. In other parts of the world, a different pattern is emerging: According to the World Bank, growth in major East Asian and Pacific economies is projected to be higher and inflation lower than in the rest of the world, due in part to sustained global demand for exports of manufactured goods.³⁵

These and other global shifts are impacting currency markets. During the summer months in Europe, the euro fell below parity with the US dollar,³⁶ its lowest level in 20 years, while in September the British pound hit a record low against the US currency.³⁷ Meanwhile, the Japanese yen hit its 24-year low against the dollar.³⁸ Currency headwinds are weighing on global businesses. With the US dollar widely considered to be a premier currency for international trade, many companies around the world are having to adjust their performance outlooks.

To be sure, currency fluctuations are also creating opportunities for international companies operating in the US, or countries with currencies pegged to the dollar, by artificially increasing their revenue when converting back to their home currency.^{39,40}

Consumer Caution

Consumers are facing higher prices on multiple fronts, from groceries to petrol, straining household budgets⁴¹ and impacting consumer confidence.⁴² In a summer 2022 McKinsey survey, US consumers reported they were twice as pessimistic about the economy than during the prior two years.⁴³ In Europe, consumers cited rising prices, the war in Ukraine and extreme weather events as the top reasons weighing down their sentiment, according to another McKinsey survey from the summer,⁴⁴ with respondents predicting they would make the biggest cuts in spending on apparel, footwear, and accessories and jewellery.⁴⁵ In China, continued Covid outbreaks have dampened consumer spending, as illustrated by the Golden Week holiday in October 2022, when consumer spending was down 26 percent year on year, the lowest level since 2014 and less than half of 2019’s spending.⁴⁶

Many shoppers are becoming more cautious about their discretionary purchases, indicating that the surge in spending on apparel and other segments following the height of the pandemic is reaching an end, if it has not already ended.⁴⁷ According to the BoF-McKinsey State of Fashion 2023 Survey, 45 percent of fashion executives expect to update their assortment mix to adapt to lower consumer purchasing power, while 72 percent plan to increase retail prices to help their companies manage the inflationary environment.⁴⁸

Consumer behaviour could turn suddenly, again, from cautious to confident if economic signals brighten. However, brands should remain flexible to respond to a potential, and sudden, release of pent-up shopping demand and uneven patterns emerging across different markets.⁴⁹ Brands should also anticipate the fragility of these changes. While high-income households will be most likely to continue shopping in 2023, given their relatively healthier financial foundations, even they may prioritise saving over spending out of caution.⁵⁰

Plan and Pivot

The fashion industry weathered unprecedented challenges in recent years, and 2023 will test its resilience yet again, albeit with some categories entering the year in a stronger position than others. According to McKinsey analysis of publicly listed companies, the luxury segment’s top-line grew 27 percent in the first half of 2022, compared to the same period in 2021,⁵¹ while luxury groups like LVMH and Kering reported double-digit growth for the first nine months of 2022 and have increased their revenue projections.^{52 53 54} If the impact of inflation follows that of prior slowdowns and predominantly effects lower- and middle-income consumers,⁵⁵ industry analysts expect the luxury category to be more resilient than the rest of the fashion market.

While high-income households will be most likely to continue shopping in 2023, given their relatively healthier financial foundations, even they may prioritise saving over spending out of caution.

Even so, companies’ scenario planning during the year ahead must sufficiently capture the increased levels of uncertainty, with contingency programmes under varying scenarios clearly mapped out. Fashion leaders will need to prepare for a number of economic and political outcomes. Some of fashion’s more challenging scenarios may play out in the developing world, where local conflicts in manufacturing hubs can escalate and impact industry practices. For example, the 2021 coup in Myanmar is among the factors that have left the country highly vulnerable to conflict or collapse, according to annual research from think-tank Fund for Peace.⁵⁶

At the same time, trade wars and sanctions

can limit access to raw materials and energy sources while obstructing supply chains. Severe floods in Pakistan and Brazil as well as extreme temperatures in India in 2022 show how climate disruptions can hinder both raw material production and manufacturing operations that are critical to the fashion industry.^{57 58} Similarly, new Covid-19 restrictions imposed in China that impacted factories and ports in 2022 demonstrated the industry’s reliance on the country as a manufacturing hub.⁵⁹

When considering scenarios for key markets, brands should hone their flexibility, agility and speed to balance the realities of short-term crises with long-term strategic priorities.^{60 61 62 63} Key projects, like investments in digitisation advancement and the reduction of environmental impact, should not be abandoned.

The ultimate aim for fashion leaders will be to build resiliency, which will require a renewed focus on profitability. Before the pandemic, the industry experienced a period of high growth, during which many brands focused on their top lines and building market share. Funding was cheap and accessible, boosted by inexpensive debt and eager investors. In the year ahead, investors are expected to be more cautious, showing a high, if not singular, preference for businesses with robust margins. Brands with weaker margins or market positions, such as mid-market brands, will be particularly vulnerable. (See the McKinsey Global Fashion Index on page 112.) A focus on the bottom line in this inflationary climate will require difficult trade-offs between, for example, capping salaries or investing in pay rises to retain key employees in a competitive job market.

Growing profitability will entail multiple actions, including learning how to better manage unpredictable consumer patterns while staying ahead of supply and demand pressures. Companies that had wanted to avoid supply chain disruptions ahead of the downturn by placing advanced orders are now facing record inventory levels and will

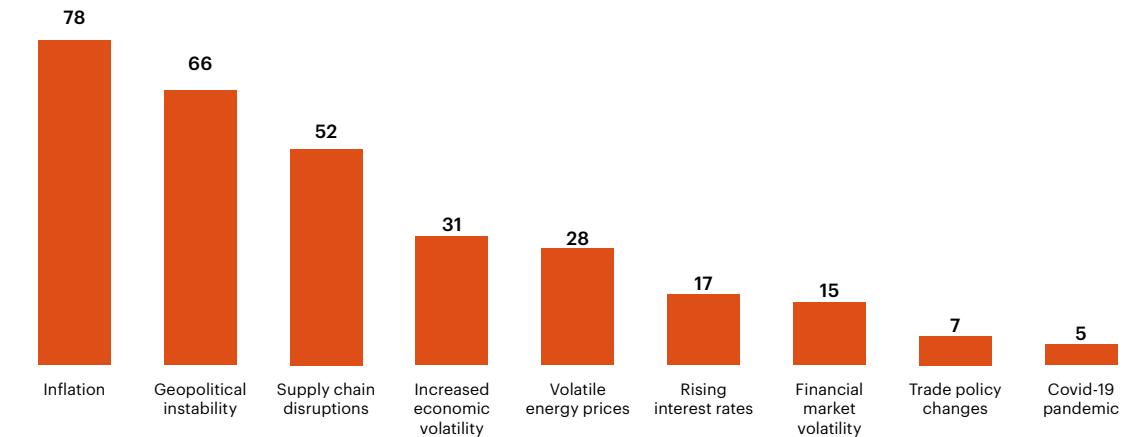
likely need to discount substantially to clear stock.⁶⁴ Creating greater flexibility across inventory management systems will help minimise such challenges. For example, technology can help with re-routing supply to low-congestion ports and shipping lanes to reduce the time goods are in transit or by optimising the assortment mix between season-agnostic and seasonal products.⁶⁵ Fashion leaders must also monitor capital efficiency with granularity to be able to re-allocate resources as needed.⁶⁶

Having a resilience mindset will be non-negotiable in 2023. For fashion executives, this will require putting contingency planning centre stage and embedding clear accountability for business performance throughout every part of their organisations. By taking an all-hands-on-deck approach, leaders can strengthen their companies’ positions to flourish even amid global volatility and economic uncertainty.

Exhibit 5:

Inflation, geopolitical instability and supply chain disruptions are the top risks for fashion businesses in 2023, far eclipsing Covid-19

Top three risks to fashion businesses in 2023, % of respondents



Source: BoF-McKinsey State of Fashion 2023 Survey

Managing Inflation for Growth

After years of benign macroeconomic conditions, volatility and uncertainty are back on the global agenda, fuelled by soaring energy prices and accelerating inflation. As rising prices squeeze fashion industry margins, central banks are lifting interest rates to the highest levels for at least 15 years, producing a dampening effect on consumer sentiment. In response, fashion decision makers need to act quickly to build resilience and plot new avenues to profitable growth.

by Emily Reasor, Aaron Rettaliata, Jesse Nading and Jad Hamdan

Industry earnings statements over the recent period have made for bleak reading. Cost pressures have impacted nearly all categories, putting increased pressure on margins and volume, and making any return to pricing “normalcy” feel far off. Indeed, secondary effects mean prices are rising through the value chain, and wages are following suit — in the US they are rising twice as fast as in 2019. Meanwhile, consumers are drawing back. McKinsey’s most recent Consumer Pulse Survey shows 37 percent of consumers plan to reduce discretionary spending and 74 percent say they are trading down when shopping.⁶⁷

For most fashion companies, inflation is top of their list of concerns for 2023. However, they also understand that change does not happen easily or overnight. With buying and merchandising cycles stretching to 18 months in some cases, decision makers need to think carefully about how to plan for secondary effects and manage their margin structures over time. Those that act robustly have an opportunity to establish a durable advantage against their competitors. Conversely, a tepid response is likely to lock in a multi-year cycle of margin erosion and underperformance.

Diverse Challenges

While inflation has near-universal impacts, the specific challenges facing fashion players often reflect their regional exposures and business models. In the US, for example, the Federal Reserve has taken an aggressive approach to taming inflation, with the Federal Reserve’s key rate expected to rise above 4.5 percent in 2023. Moreover, private sector wage growth has been stronger than in other regions, suggesting inflation may prove sticky in the longer term. In Europe, by contrast, inflation is being driven by energy prices, and may therefore resolve more easily once the impacts of the war in Ukraine abate. Still, currency fluctuations are likely to continue to affect companies with costs in US dollars and sales in euros.⁶⁸

Asia is an outlier in the global context, in that a relatively benign inflation environment is being offset by slow growth and the continuation of Covid-related economic impacts, particularly in China.⁶⁹ However, the region’s financial health is being undermined by rising US interest rates and high commodity prices. Meanwhile, Latin America presents a mixed picture, with some countries

putting in place an aggressive monetary response to inflationary risk, while others remain in relatively good shape.

Navigating Turbulence

The challenging economic environment has had asymmetric impacts across fashion business models. However, in general, businesses with the highest exposures to disposable income are facing the biggest challenges.

In the luxury and affordable luxury segments, many well-known brands have remained insulated, or partially insulated, from the impacts of inflation and macroeconomic turbulence. LVMH, which owns brands including Christian Dior, Fendi and Givenchy, reported organic 20 percent revenue growth to €56.5 billion (approximately \$55.8 billion) in the first nine months of 2022, compared to a year earlier.⁷⁰

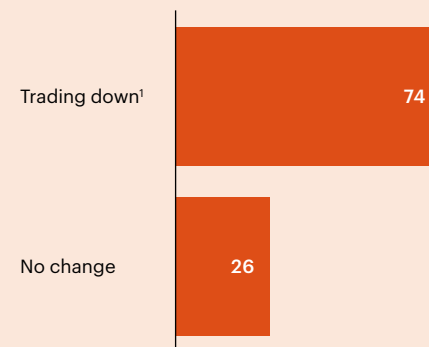
Among premium brands, the picture is mixed. Value-conscious consumers are trading down into value, off-price and private label brands, while higher-income consumers are less likely to switch. As highlighted in recent US earnings calls, the environment is particularly tough for companies that have overbought inventory and are contending with supply chain issues. This has led in some cases to declines in gross margins and a wave of discounting.

As consumers trade down, the value segment may benefit. Indeed, retailers can optimise their propositions by shifting away from brand-name products and toward more private-label offerings. In addition, an agile approach to product design can be a winning strategy, allowing manufacturers to reset their cost bases and cater to shifts in consumer demand, albeit with a delayed impact on the bottom line. Similarly, the discount segment is well placed to navigate the

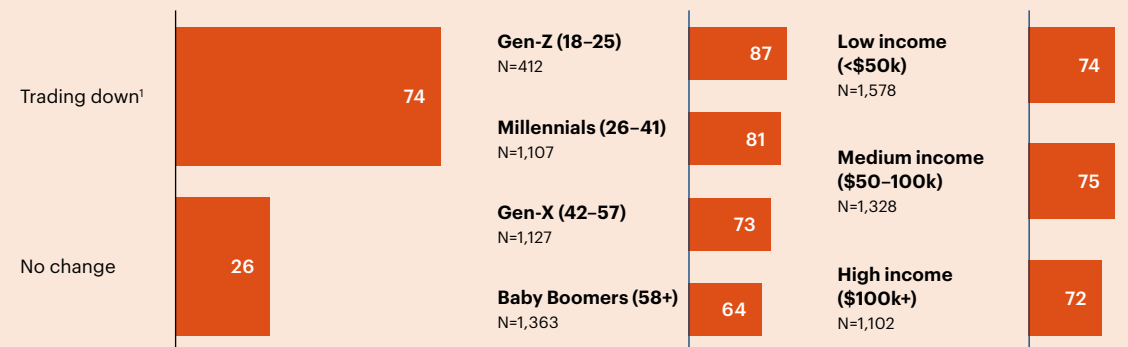
Exhibit 6:

US consumers are trading down to lower-priced brands and products across income groups and generations

US consumers changing their shopping behaviour, % of respondents



Consumers trading down, by generation and income level, % of respondents



¹ Trading down includes one or more of the following: shopped from a lower priced retailer, shopped from lower priced brand, bought private label, bought with a coupon, used buy now pay later, delayed a purchase, bought a larger size pack for lower price, bought smaller size or quantity, made more shopping trips in search of discounts.

Source: McKinsey & Company US Consumer Pulse Survey

current environment. The strongest demand is likely to be from lower-income consumers, who will feel the impacts of inflation more than their peers.⁷¹ Moreover, off-price retailers will benefit by picking up low-cost inventory from under-pressure retailers further up the food chain.

Fashion Players Can Respond

While inflation is running at the fastest rate for decades, and consumer sentiment remains subdued, fashion companies are well-placed to take action that could offset pressure on performance. Here we gather six ideas that leading businesses have harnessed to optimise their approaches:

Triple your productivity effort:

Amid pervasive price rises through the value chain, productivity will be a key success factor. Players should conduct a rigorous assessment of input costs and double down on indirect spend and organisational efficiencies to maximise

productivity. Leading manufacturers are also resetting their cost bases through design-to-value thinking. Meanwhile, suppliers and vertically integrated players can recalibrate their supply and distribution networks. A third option is to relocate distribution centres to balance labour economics with last-mile costs, or use third-party logistics and supply-chain-as-a-service providers to reduce asset intensity and distribution overheads.

Reset your assortment and category strategy: Consumers are letting their wallets do the talking. In the early months of 2022, 67 percent of consumers that tried a new brand cited value as a reason for switching, an increase of 9 percentage points from October 2020. Meanwhile, about a third of consumers have switched to a private label brand over the past year.⁷² Fashion players can respond to these trends by revising their assortments and sharpening entry-level price points. Retailers, meanwhile, can extend private-label offerings. Winners will also leverage data and

analytics capabilities to work out where consumers are most price sensitive and which segments are the most exposed to inflation. Looking ahead, retailers seeking to improve private-brand penetration could foster awareness and loyalty by adopting consumer-led brand strategies and category management, as well as ramping up design capabilities.

Surgically rebase your value equation:

Instead of implementing broad price increases that erode customer trust, retailers could reprice by customer and product segment, taking into account both margin performance and willingness to pay. In parallel, they could introduce personalised promotions and loyalty initiatives, especially for products that are highly exposed to inflation or are important to customers. This can strengthen relationships while alleviating margin pressure by reducing the need for mass promotions. Fashion players that take a surgical approach to these endeavors are more likely to emerge with profitability and consumer relationships intact. In addition, to win or retain near-term market share, businesses may consider absorbing some higher costs.

Consider adjusting discounts and promotions: Several leading players are re-evaluating their pricing and promotion mixes, helping them manage volatility without punishing consumers. In addition, forward-looking companies have shown that data and analytics can help them become more precise in their efforts, as well as more effective in managing inventory surplus, value perception and margins. There is also an opportunity to better manage attributes that the data reveals are valuable to consumers.

Reimagine your labour model: To counter the effects of labour cost inflation, retailers could look for opportunities across their business model. These may comprise deploying more technology and analytics, resetting labour allocation, reviewing scheduling and taking an end-to-end approach to managing costs. Half of US retail employees are considering leaving their jobs, a much higher proportion than in the wider economy. Therefore, it makes sense to invest in the frontline

employee experience, leveraging recruitment and talent analytics to beef up capabilities, and refreshing ideas that could encourage staff to remain in their jobs.

Scale up management capacity and decision making: In a challenging macroeconomic environment, executive teams have a vital role to play. This is an ideal time for decision makers to remove bottlenecks and streamline communications and workflows with vendors, supply teams, design teams, and store and e-commerce operatives. Tactically, this could mean improving visibility into cost structures and strategically communicating across the organisation — and with vendors and suppliers. By accelerating decision making, fashion players can focus minds on delivering pricing that achieves the highest return on investment, especially when responding to competitor moves. Accordingly, leaders need to define KPIs that both track customer behaviours and measure the effectiveness of initiatives. For instance, by carefully monitoring product categories for declining volumes and basket size, they can spot signs of behaviour changes caused by price sensitivity.

Inflation and economic uncertainty are powerful drivers of fashion industry performance, and are unlikely to abate anytime soon. Therefore, the task for decision makers over the coming months will be to impose short-term tactical discipline on business models, but at the same time embed strategies that promote flexibility, clarity and fast decision making across geographies and operations.

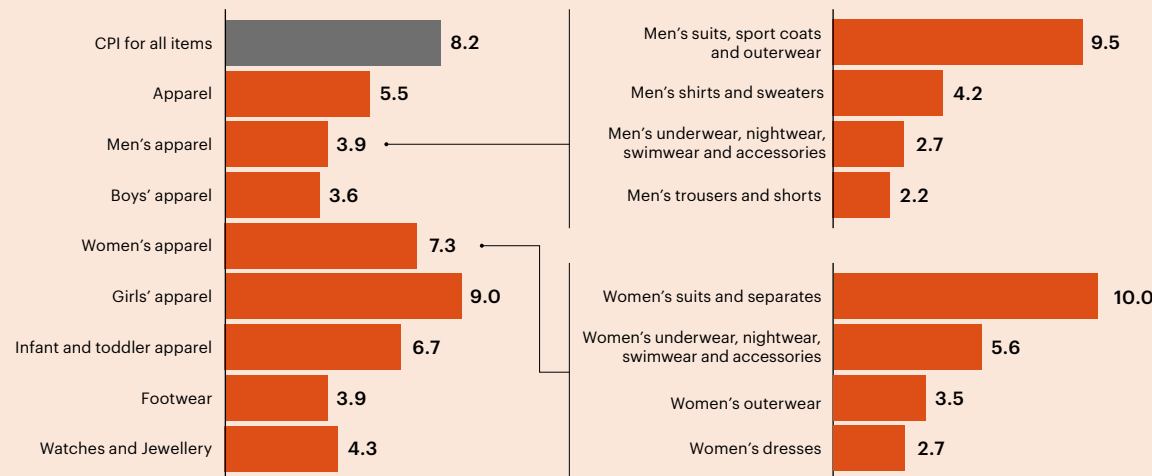
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Exhibit 7:

Within fashion, prices are rising more in some categories than others

US Consumer Price Index, June 2021-June 2022, CAGR %



Source: BLS



02. REGIONAL REALITIES

Understanding where to invest globally has never been easy but rising geopolitical uncertainty and uneven post-pandemic economic recoveries, among other factors, will likely make it even more challenging in 2023. Brands can re-evaluate regional growth priorities and hone their strategies so they are more tailored to the geographies in which they operate.

KEY INSIGHTS

1. Growing geopolitical uncertainty and slower-than-expected recoveries from the pandemic have shifted the world map of growth opportunities for fashion brands, and executives are intending to take action.
2. Markets that fashion brands have prioritised in their growth strategies, such as China, are signalling a slowdown ahead.
3. Regions like the Middle East and the US have emerged as priorities for the year ahead: 88 percent and 78 percent of fashion executives believe the respective regions will have the same or higher growth prospects in 2023 compared to the previous year.

EXECUTIVE PRIORITIES

Re-evaluate regional risk

Identify regions that are continuing to drive growth amid economic uncertainty, such as the Middle East and the US, and focus investment in those markets.

Look beyond financial outcomes

When identifying regional opportunities and defining priorities, place greater emphasis on reputational factors, geopolitical risks, cultural differences and regulatory complexity.

Lean into localisation

Adopt an increasingly nuanced, localised approach to marketing and merchandising, empowering local teams to facilitate region-specific opportunities and respond quickly to events on the ground.

In the weeks that followed the Russian invasion of Ukraine in early 2022, more than 500 global companies across a range of sectors announced they would cease operations in Russia.⁷³ Many brands cited trade restrictions and operational difficulties as they began exiting or suspending operations. Some companies chose to also take a side in the war. They issued condemnations of violence or coupled their operational decisions with humanitarian donations. Some brands decided to hold or even expand their businesses in Russia, capitalising on the vacuum left by the departure of brands from Europe and the US. But for most brands that left, curtailing business in Russia was done with the intention of showing solidarity with and support for those calling for peace.⁷⁴

Not so long ago, such a statement would have been considered unusual, even contentious. Fashion brands have long aimed to be politically neutral in order to avoid alienating not only their customers, but also investors and business partners. But in today's polarised and interconnected world, a global brand's public, political and social affiliations can impact its relationships with consumers⁷⁵ and business partners. In opting to forgo operations within a particular market, companies may lose revenues in the short term, but leaders should weigh up the impact on brand equity and consumer trust in other markets in the longer term.

For fashion executives, the politicisation of the private sector adds a new dimension to how and where they focus on growing their businesses globally. Decisions about whether to invest in a country or region can no longer be confined to its economic potential. Today, fashion leaders should consider the social tensions and political uncertainties that can obstruct business operations or escalate reputational risk. Many of the priorities based on the geographic markets that were central to the fashion and luxury industry in recent years are shifting as a result.

China Through a Changing Lens

In recent years, many Western fashion brands pivoted their foreign investment to the Chinese market, with good reason. Even during the pandemic in 2020, China accounted for 25 percent of global apparel and footwear sales, ahead of the US and Western Europe with 20 percent and 22 percent respectively.⁷⁶

China's GDP has more than doubled over the course of a decade, from \$8.5 trillion in 2012 to \$17.7 trillion in 2021,⁷⁷ fuelled by urbanisation and increased productivity, alongside a large and growing middle class with disposable income, helping it to grow faster than other major global economies.

Though still a critical market, China is now facing a changing growth trajectory.⁷⁸ In October 2022, the International Monetary Fund forecast China's GDP to grow 3.2 percent for the year,⁷⁹ compared with 8.1 percent in 2021,⁸⁰ citing a property sector crisis and partial or full lockdowns in response to outbreaks of new Covid-19 variants in more than 70 cities, spanning key fashion shopping hubs like Shanghai, Beijing, Shenzhen, Guangzhou and Chengdu.⁸¹ In the third quarter of 2022, the country's GDP grew below target, casting a shadow over investor sentiment amid concerns about the country's longer term outlook.⁸² HSBC estimated that retail sales were down 40 percent year on year in April and 50 percent in May due to store closures.⁸³

Even without the threat of further Covid outbreaks, the Chinese market presents other challenges specific to foreign fashion brands. For example, some Chinese consumers are starting to favour domestic brands over their foreign counterparts. Sales of foreign-branded sneakers on Chinese online retailer Tmall decreased 24 percent year on year in 2021, while domestic brands' sneaker sales grew 17 percent. Sportswear apparel saw a similar shift, with foreign-brand sales declining 33 percent compared with domestic brands' 13 percent growth year on year.⁸⁴

Meanwhile, income inequality in China is widening, nearly reaching 2008 levels,⁸⁵ and youth unemployment is rising.⁸⁶ In addition, major institutions like the World Bank are concerned that the country is too reliant on debt-financed infrastructure and real estate investment as a means to stimulate growth.⁸⁷ As of September 2022, the value of new home sales and levels of property investment were down 29 percent and 12 percent year on year, ominous signs when 70 percent of Chinese household wealth is tied up in real estate.⁸⁸

Amid all this, however, China's long-term growth projections remain robust. By 2040, its GDP is projected to reach \$47 trillion, widening the gap with the US, at \$28 trillion, and the euro zone, at \$19 trillion.^{89 90} China will likely remain a core market for fashion consumption in the long term, with significant untapped opportunities among a customer base whose sentiment for luxury brands in particular is holding strong.⁹¹

Fashion brands can adjust their strategies accordingly. Many brands are already directing their investments into China's shopping hubs where growth appears to be the most robust. Brands opening new or refurbished stores include Hermès in Wuhan, Ralph Lauren and Louis Vuitton in Chengdu, and Marni and Maison Margiela in Shanghai. Others are doubling down on the luxury duty-free opportunity by expanding in the emerging shopping hub of Hainan.⁹²

Resilience in America

US-based fashion groups Capri Holdings and Tapestry, which generate more than half their sales in North America,⁹³ delivered strong results in 2022.^{94 95} Overseas brands also fared well, with the Americas being the fastest-growing market for Spanish fashion group Inditex, with sales increasing 45 percent year on year in the first half of 2022,⁹⁶ while Swiss sportswear brand On grew sales in North America at 102.5 percent year on year over the same period.⁹⁷

It was not just at home that Americans continued to shop. As pandemic-related travel restrictions lifted, shopping in Europe was made even more attractive to Americans, bolstered by a strong dollar against the euro and pound sterling. Luxury brands in Europe cited American tourists as a key driver of increased first-half sales, including a 47 percent rise at LVMH and 53 percent rise at Kering.⁹⁸

For fashion executives, the politicisation of the private sector adds a new dimension to how and where they focus on growing their businesses globally.

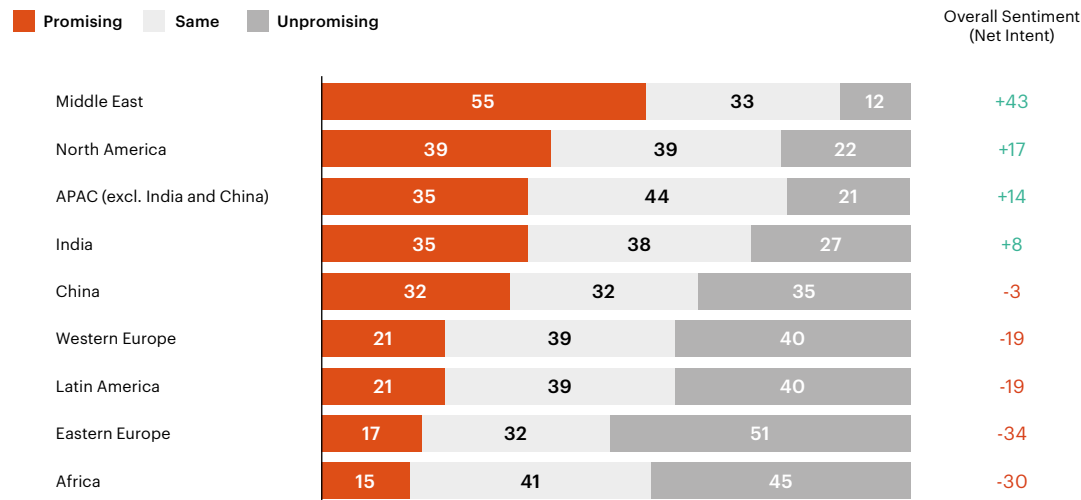
With overall US retail sales expected to close 2022 on a two-decade high,⁹⁹ the sector will have a strong foundation heading into 2023. Meanwhile, the US has also reclaimed its spot as the largest market for luxury goods in the world in 2022,¹⁰⁰ even if the country will likely concede this position to China again in the near term. "The US is proving to be a long-lasting source of growth for the luxury industry, fuelled by younger generations who are highly engaged with the category," said José Neves, co-founder and chief executive of luxury e-commerce platform Farfetch,¹⁰¹ which generated over 20 percent of its revenue from the US market in 2021,¹⁰² further confirming its confidence in the market, it acquired a minority stake in Dallas-based luxury department store Neiman Marcus in 2022.¹⁰³

Some fashion companies are targeting second-tier US cities for new growth, as wealthier demographics have taken advantage of remote work to seek out alternatives to higher-cost cities like New York, Los Angeles and San Francisco.¹⁰⁴ Luxury labels Saint Laurent and Gucci are set to open stores in locations like Detroit, New Orleans and Columbus.¹⁰⁵ MyTheresa and Saks Fifth Avenue,

Exhibit 8:

The Middle East and North America are expected to be the regions with the highest growth potential in 2023

Markets by expected growth prospects in 2023 compared to 2022, % of respondents



Source: BoF-McKinsey State of Fashion 2023 Survey

among other luxury retailers, have also begun staging or strengthening VIP events in cities like Palm Beach, Dallas and Miami to deepen relationships with wealthier clients who are not based in the country's traditional fashion capitals.¹⁰⁶

However, amid uncertainty in the stock market and rising inflation — as well as the Federal Reserve continuing to hike up interest rates — the US is not immune to economic turbulence felt elsewhere.¹⁰⁷ Credit card data from the autumn of 2022 showed Americans had cut back on buying luxury goods ahead of the holiday season, suggesting shopping sentiment could be petering out. The sharpest cuts were among middle-income customers.¹⁰⁸ Luxury brands may find entry-level customers in particular pull back their spending as economic conditions deteriorate. To be sure, the

US may be more resilient than other key markets, but brands should be cautious and be prepared for a potential slowdown in the US market, too.

Growth Drivers in APAC

In the Asia-Pacific region, Japan and South Korea are renewing their reputations as dependable growth drivers, particular in luxury, amid China's recent slowdown and sustained post-pandemic demand. But both markets require brands to update their local strategies to capitalise on shifting shopping habits.

Consumer demand in Japan and Korea was particularly resilient coming out of pandemic lockdowns, benefitting from an influx of international tourists.¹⁰⁹ Domestic shoppers in

Japan and Korea has been driving the countries' economic recoveries, as they largely filled the void left by home-bound Chinese tourists. Japan's economy recovered to its pre-pandemic size in August 2022, fuelled by increased consumer spending after Covid restrictions were eased in March 2022,¹¹⁰ while Korea reached the same milestone in April 2021,¹¹¹ and the country's consumption and GDP growth rates continued to exceed analyst expectations in 2022.¹¹²

During the pandemic, Western brands in these countries learned how to adapt to Covid restrictions, such as by introducing remote sales strategies. For Italy-based Moncler, private appointments and distance sale transactions, where customers make purchases from home via video calls with sales associates, now account for 30 percent of sales in Korea and 20 percent in Japan.¹¹³ Meanwhile, department store groups Shinsegae, Lotte and Hyundai are expanding in Korea to accommodate global brands' desire to capture domestic demand.¹¹⁴ Other brands have laid the foundations for further growth in Japan. For example, foreign luxury labels including Hublot, Zegna¹¹⁵ and Chanel¹¹⁶ have opened stores recently in Tokyo's main shopping districts. Hermès saw sales in Japan increase by 22.7 percent in the third quarter of 2022, with the company citing the loyalty of local customers.¹¹⁷

Optimism in the Middle East

The outlook for fashion in the Middle East in 2023 is more bullish than for many other markets; in the BoF-McKinsey State of Fashion 2023 Survey, 88 percent of executives indicated that they believe the Middle East will have the same or more promising growth prospects in 2023 compared to the previous year.¹¹⁸ Global energy prices are rising and the Gulf Cooperation Council currencies are pegged to an appreciating US dollar. The GCC luxury market was worth nearly \$10 billion in 2021 — a 23 percent increase on pre-pandemic levels — and is expected

to grow to \$11 billion in 2023.¹¹⁹

A significant proportion of Middle Eastern luxury spending was repatriated during the pandemic as luxury consumers were unable to travel to Europe. Now, 60 percent of luxury spending occurs domestically.¹²⁰ In addition to opening new stores, luxury brands are finding other ways to home in on the GCC market, such as staging fashion shows locally and creating local content by collaborating with Middle Eastern artists on capsule collections and producing photoshoots in the region.¹²¹

Capturing Global Rewards

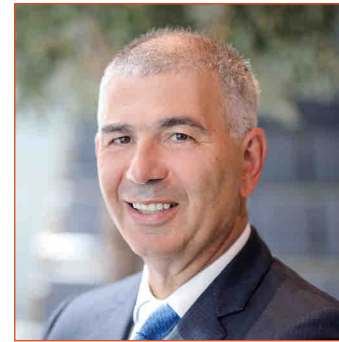
In the year ahead, geographic diversification will likely be as important as ever, but also more complex, as rapidly shifting economic, political and social forces take centre stage. When prioritising regions for global expansion, leaders can review their footprints and identify areas of growing demand while placing greater emphasis on factors beyond revenue potential, such as reputational and other risks.

Alongside an enhanced framework for risk, brands can employ a more nuanced and complex structure to evaluate the effects of political, regulatory and cultural scenarios they may encounter at home and abroad.¹²² This may require leaders to assess the interplay between different markets alongside factors within them. They will need to place greater emphasis on developing a local mindset, where on-the-ground know-how will allow fashion leaders to penetrate the market more deeply.¹²³ Local experts will also be critical for anticipating and responding to any sudden changes to scenarios and will be a point of contact for external stakeholders, such as trade or industry bodies.¹²⁴ The deeper the understanding of a region, the more effective a brand will be in doing business there.



EXECUTIVE INTERVIEW

Chalhoub Group: Capturing Fashion's Growth Potential in the Middle East



Patrick Chalhoub
Group President, Chalhoub Group

Luxury brands looking for a bright spot in 2023 are focused on the Middle East, where industry veterans like Patrick Chalhoub have served as regional partners for decades. The group president of Dubai-based retailer and distributor Chalhoub Group is bullish about growth prospects in some markets but cautions that brands will need to enhance their localisation strategies and do more to personalise their offering for increasingly “assertive” customers in the region.

— by Janet Kersnar

When scanning the globe to identify growth opportunities in the year ahead, most fashion executives responding to the BoF-McKinsey State of Fashion 2023 Survey cited the Middle East as a region that holds greater promise in 2023 than in 2022. Indeed, sales of luxury fashion in the Gulf Cooperation Council alone reached around \$4.2 million in 2021, an increase of 39 percent on 2019 levels. Future growth in the region is pegged to the return of international tourists and e-commerce acceleration, among other factors.¹²⁵

Capturing growth in the region will require brands to double down on localisation and personalisation strategies, according to Patrick Chalhoub,

GLOBAL ECONOMY

group president of Chalhoub Group, a Dubai-based luxury goods retailer and distributor which was set up by his father in 1955 and is now the regional distribution and franchise partner for hundreds of global fashion and beauty brands including Dior, Tory Burch and Yves Saint Laurent along with joint ventures with LVMH, Christian Louboutin and Farfetch.

While growth prospects are robust across the GCC region, Saudi Arabia, where luxury sales have been recording double-digit growth, stands out for Chalhoub's top executive. He sees the fashion industry playing a role in the country's sweeping Vision 2030 programme aimed at modernising and diversifying its economy.

As a veteran fashion executive in the Middle East, you will have witnessed many economic and social shifts impact the fashion market over the years. What is having a significant impact today?

We're living in very interesting times in the Middle East. Because current economic developments are like nothing we have seen for many, many years, there is a lot of wealth thanks to additional revenues coming from oil. The Middle East, and the GCC in particular, is becoming an international business destination, but also an international tourist destination, with initiatives like the Red Sea Project [on Saudi Arabia's west coast] that will be adding thousands of hotel rooms by the end of this decade.

What the fashion industry needs to do is make sure we maintain relevance for our local customers. Imagine that historically —

before 2020 and 2021 — two-thirds of luxury spending by GCC shoppers happened abroad because they perhaps weren't getting the experience, service, choice or journey they wanted when shopping locally. We need to make sure that we do not decrease the amount they are buying outside the GCC, but increase the amount they are buying locally. [We need to] be there to fulfil what they want more.

There are well-established consumer markets across the GCC, but what about, for example, Egypt, where the government is investing in the development of new cities and big infrastructure projects?

There is certainly movement in Egypt in terms of economic development. All those projects happening along the Red Sea — with all those new hotels opening — are a huge part of this drive to become more of an attractive destination to tourists from around the world.

But this comes with its own short-term challenges which are probably more complicated than in other countries. Energy is expensive, inflation is high, the exchange rate is difficult [with the Egyptian pound weakened substantially against the US dollar in 2022]. In Egypt, there is still a lot of heavy administrative ways of doing business, often for the wrong reason or reasons inherited from the past that tried to limit imports to help local manufacturing develop. I'm not sure that measures taken 30 years ago are still relevant today but changing them is still complicated there. So Egypt is there to develop but it is something that needs to gradually

build up and develop in our field of activity [in the luxury fashion market].

Localisation seems to be a big theme for global brands around the world, with consumers increasingly buying local brands imbued with local culture and heritage. How are you seeing this play out in the Middle East?

There is a movement in the Middle East, but not a movement of national pride like in China. We do want to buy locally ... and we have seen a proliferation of local fashion designers but we need to continue developing them. We are only just getting started with that.

Our group has been actively involved in assisting in early-stage local disruptor brands. We recently set up the Fashion Lab, an open innovation platform. Our regional incubator has assisted start-ups ranging from Dania Shinkar [handbags] to Noms Life [lifestyle brand] and Kaf by Kaf [ready-to-wear] to Cones & Rods [eyewear].

What can global brands do to ensure that they are in tune with their Middle Eastern customers?

It helps for brands to review and revisit the way business is done and the kind of experiences that are relevant for the Middle East. We are already seeing that. For example, the end of the fasting period of Ramadan is very festive, and we are seeing a lot of specific collections done for it. Probably 60 percent, 70 percent of brands have made a cruise collection just for that specific celebration.

We are seeing that brands are much more interested in doing

EXECUTIVE INTERVIEW

specific or personalised events and activations. I never saw so many global luxury brand-led events that resonated with the GCC's audience as I did in 2021 and 2022. Brands like Chanel, Hermès, Louis Vuitton, Cartier and Tiffany have been working on local strategies to attract consumers in the region through collaborations, dedicated collections and immersive events in iconic locations such as Al-Ula in Saudi Arabia. However, a lot of personalisation is needed in this region. Middle Eastern customers will build up trust in big brands, but they need [brands to provide] points of differentiation.

How are customers in the region different today than pre-pandemic or during the height of the pandemic? What will the new consumer profile in 2023 look like in terms of demographics and purchasing decisions?

[Generally], we are seeing more assertiveness among our consumers. The younger the consumer is, the more we see it. They are still attached to branding, but less so. They also have more curiosity, and so are more eager to try a new brand, even a local fashion designer, rather than a global one. We are also seeing customers mixing brands and products more and more, because of this assertiveness in terms expressing themselves. They don't feel that they should necessarily be dressed from head to toe in one brand.

In terms of product categories, there is a big surge in jewellery. I hear that this is not just in the Middle East, but worldwide. Jewellery has always been extremely important in the

Middle East, but not branded jewellery, like now. It helps that the brands are becoming more and more creative.

The customer journey is adapting too. People often like to go into stores in [groups], with family and friends, so they need more areas for seating, more space, and not just at a counter for people in a hurry. We really need to make those kinds of adaptations.

Unlike in other parts of the world where e-commerce growth is returning to pre-pandemic levels, e-commerce seems to be accelerating in parts of the Middle East. What's fuelling that?

The story behind that is that we are quite late compared to other regions in terms of the percentage of sales done through digital channels, for various reasons. For example, the content might not have been relevant or there was not enough choice. All of this is improving; the customer experience itself, the availability of products, the relevance of content. Having said that, what we have seen in 2022 is that there is bigger growth in brick-and-mortar than e-commerce.

There is another aspect of brick-and-mortar that I'd like to mention. For developing countries, real estate development is often a challenge. When there is a surge in demand for real estate — like we saw in 2019 and again in 2021 and 2022 — you have scarcity of supply, which not only increases prices, and any new project will take five to seven years to complete. Now we are in a cycle in which there is much more demand in some cities, such as Riyadh [Saudi Arabia] and Doha [Qatar], than

others. We really need to be more dynamic and creative about how to solve this tension, because there is scarcity of locations, and maybe this requires a different way of thinking about different consumers.

Chalhoub Group recently announced that it is buying a majority stake in Threads Styling, an online, personalised, chat-based luxury fashion and jewellery shopping service. How does this fit into the group's overall strategy to build out digital capabilities?

We are embarking on the digital world quite late. Before the pandemic, e-commerce represented around 1 percent of our turnover; today it is approximately 10 percent.

The group represents and runs over 80 e-commerce websites and apps for partners and joint venture brands in the [Middle East-North Africa] region. And since 2018, we have had a joint venture partnership with Farfetch in the GCC and Levant [Egypt, Jordan and Lebanon], which includes an Arabic language site. But we have a lot to learn to be closer to the digital-native consumer ... which is what we find fantastic in Threads Styling. It's really about clienteling, taking care of our client, and connecting with them, and keeping the human touch, even if we have all the digital devices.

This interview has been edited and condensed.

CONSUMER SHIFTS

03. TWO-TRACK SPENDING

04. FLUID FASHION

05. FORMALWEAR REINVENTED



03. TWO-TRACK SPENDING

Consumers may be impacted differently by the potential economic turbulence in 2023. Depending on factors including disposable income levels, some will postpone or curtail discretionary purchases; others will seek out bargains, increasing demand for resale, rental and off-price. Fashion executives should adapt their business models to protect customer loyalty and avoid diluting their brands.

KEY INSIGHTS

1. Shopping behaviour will diverge across income groups. While high-income shoppers with savings, access to credit and greater job security may continue spending on fashion, lower-income consumers will tighten or cut discretionary spending.
2. Customers may seek out lower-priced retailers and discounts, particularly in younger cohorts. Over 75 percent of US Gen-Z and Millennials said they are taking steps to manage finances, compared with Gen-X's 64 percent and Baby Boomers' 53 percent.
3. Off-price channels will grow — forecast to account for 12 percent of fashion industry revenues by 2025 — as will resale, which is expected to grow 11 times faster than apparel retail by 2025.

EXECUTIVE PRIORITIES

- | | |
|--|--|
| Develop nuanced customer profiles | Analyse how customer groups in different demographics and locations are shifting their behaviours and adjust strategies in response by introducing new channels, pricing strategies or product categories. |
| Turn on off-price | Selectively explore how to capture value from promotions and discounts with strategic off-price partners without diluting brand value. |
| Explore the 3 Rs | Evaluate how new models like resale, rental and repair can be integrated into the value proposition to allow consumers to combine responsible and affordable consumption. |

CONSUMER SHIFTS

Brands and retailers that weathered 2008's global financial crisis can be forgiven for feeling a sense of *déjà vu* as a steady stream of macroeconomic data signals challenging times ahead. Just like in 2008, consumer confidence has plummeted to record lows in reaction to economic uncertainty¹²⁶ and households have reined in spending.¹²⁷

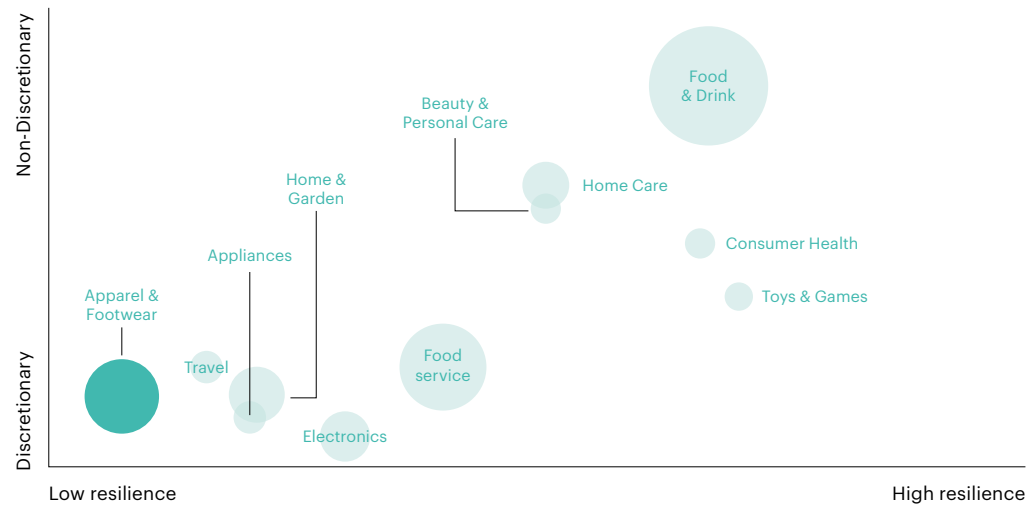
Economists increasingly expect lower-income households to bear the brunt of economic stresses over the short to medium term, particularly if the relatively low unemployment levels in some regions were to change dramatically.^{128 129} In regions such as Central and South America, consumers are already struggling

to cover everyday expenses, as income levels fail to keep pace with escalating inflation, which hit a 26-year high in Brazil and 21-year high in Mexico in 2022.¹³⁰ Many lower-income households will likely deprioritise discretionary spending, including fashion and beauty purchases.¹³¹ In the US, customers are "trading down." A McKinsey US Consumer Sentiment survey conducted in the summer of 2022 found that 74 percent of respondents said they have been shopping from more lower-priced retailers or brands than usual, seeking discounts at their "go-to" retailers or paying for goods in instalments; 45 percent said they recently delayed making a discretionary purchase.¹³²

Exhibit 9:

Consumers are expected to deprioritise apparel and footwear as rising prices diminish disposable incomes

US and Europe category product resiliency
Bubble size = US and Europe category value (USD MN)



X axis: Historical resiliency based on 2008 global financial crisis performance; Brazil's inflation crisis (2015); performance during Covid-19
Y axis: Qualitative category assessment; future spending intent, based on McKinsey consumer sentiment surveys between June and July 2022 in the US and Europe
Source: McKinsey analysis based on Euromonitor and McKinsey Europe Consumer Pulse Surveys

03. TWO-TRACK SPENDING

It is a different story for higher-income households, for now. These consumers should be less impacted by economic turbulence and look likely to continue spending on discretionary goods, in the short term at least. In a recent survey, 26 percent of higher-income consumers in China – which is among the countries where economic growth is slowing – said they increased their fashion shopping budgets in the first half of 2022 compared to the same period in 2021, citing a desire to "look and feel good." Similarly, US credit card data from the spring of 2022 suggested that wealthier shoppers were increasing their spending on apparel.¹³³

Generational differences are also noteworthy. In the US, spending among younger consumers is expected to suffer the most: 76 percent of Gen-Z and 79 percent of Millennials reported that they are dipping into their savings, taking on more credit or taking on additional jobs to manage their finances, compared with 64 percent of Gen-X and 53 percent of Baby Boomers.¹³⁴ In China, though inflation is less of a concern, younger generations are feeling the burden of an economic slowdown,¹³⁵ driven by new outbreaks of Covid-19 and rising youth unemployment. The unemployment rate among 16 to 24 year olds in the country reached nearly 20 percent in 2022 compared to the overall national rate of 5.5 percent.¹³⁶ Now, many young adults are embracing humbler lifestyles than their parents, in a shift described as *tang ping*, loosely translated as "checking out of the rat race to pursue a more low-key life."¹³⁷

Retailers are bracing themselves for reduced spending among younger generations: "We see [younger and less affluent] customers spending much more cautiously on discretionary items and often waiting for promotions before buying," said Richard A. Hayne, chief executive officer of retail group Urban Outfitters in August 2022.¹³⁸

This includes turning to alternative payment methods and short-term financing,

which has seen a boom in popularity and has helped to fuel apparel sales over the past year. In the US, 20 percent of customers said they bought discretionary goods in 2022 with interest-free, short-term financing, including Buy Now, Pay Later services.¹³⁹ BNPL apps are particularly popular in the Nordic region, the UK and Germany.¹⁴⁰ However, BNPL providers such as ClearPay and Affirm may face headwinds as lower-income consumers pull back on spending while the likelihood of a rise in default rates increases as economies continue to slow. Brands should consider BNPL where appropriate while monitoring changing consumer behaviours – and potentially focus more on promotions and special offers.

Flight-to-Value Behaviour

One way the fashion industry has been responding to spending shifts is to lean more heavily on discounting. According to global research from the summer of 2022 by retail tracking firm Edited, there have been year-on-year increases in discounting in several countries following a low during the summer of 2021. In the US, 36 percent more items were discounted in 2022 compared to 2021.¹⁴¹

Off-price channels are continuing to be attractive to bargain-hunters seeking big-name brands at lower prices. In Europe, off-price channels are expected to account for 12 percent of all fashion industry revenue by 2025, up from 11 percent in 2021.¹⁴²

Many off-price players were able to leverage the period after lockdown restrictions were lifted, during which US consumers splurged on purchases. In the US, sales at off-price retailers like Burlington and Ross Stores, and off-price divisions of retailers like Saks Off Fifth, grew more than 40 percent year on year in 2021.^{143 144} In the months ahead, off-price channels should benefit further from high inventories as brands see diminished supply chain disruptions coincide with a softening of consumer demand. The trend has accelerated in China too,

CONSUMER SHIFTS

where the number of fashion outlet malls has increased by more than 35 percent since 2019.¹⁴⁵

For brands, particularly higher-end ones, off-price channels should be carefully managed to avoid eroding brand perception among consumers. For example, Ralph Lauren has reduced its reliance on off-price and aims to use the channel for offloading merchandise misses, rather than selling low-margin products in high volumes like so many other luxury brands do.¹⁴⁶

There is also some evidence of consumers shopping for a more accessible type of luxury. Many newer luxury brands are catering to younger, more fashion-forward consumers that are looking to trade up from premium brands or wish to complement their wardrobes with more accessible pieces than can be found in the offerings of ultra-luxury players. This new category of brands has seen a surge in popularity in recent years; for

example, Jacquemus is on track to double its sales by the end of 2022.¹⁴⁷

While higher-end luxury brands have been “premiumising” their merchandise and increasing prices, some entry-level luxury consumers are trading down to more affordable brands that still have high-end brand storytelling and aesthetics.

Changing Channels

There is a role for resale here, too. Resale revenue is expected to grow to \$47 billion by 2025, from \$15 billion in 2022 — 11 times faster than apparel retail overall, albeit from a lower base.¹⁴⁸

Online resale channels are growing in popularity in China. A 2020 survey of Chinese consumers from UBS found that 72 percent of respondents had increased their purchases on luxury resale via online platforms, compared to 31

03. TWO-TRACK SPENDING

percent who had done so in 2018.¹⁴⁹ For some time now, Gen-Z consumers in China have been heading online to platforms like Xianyu, Zhuanzhuan and Idle Fish to buy and sell second-hand and slightly used fashion.^{150 151}

Regardless of age, resale shoppers say price points are driving this switch in shopping behaviour. A 2022 survey from American resale platform ThredUp found that 63 percent of respondents said they mainly shop resale to save money.¹⁵²

76 percent of Gen-Z and 79 percent of Millennials reported that they are dipping into their savings, taking on more credit or taking on additional jobs to manage their finances.

The popularity of resale has not been lost on big brands. Lululemon, Dr. Martens and Patagonia, among others, have started offering resale in recent years through their own service or through third parties.¹⁵³ In addition to Kering’s 2021 investment in retail platform Vestiaire Collective,^{154 155} Farfetch announced plans to acquire B2B resale-technology platform Luxclusif to help expand the category.¹⁵⁶ Meanwhile, Amazon has partnered with reseller What Goes Around Comes Around to sell pre-owned handbags from luxury brands.¹⁵⁷

Resale also creates opportunities for intermediaries. Technology and logistics platform Reflaunt recently partnered with Balenciaga to develop the brand’s resale solution.¹⁵⁸

Like resale, rental is expected to capture the attention of more shoppers and brands after struggling during pandemic lockdowns. As consumers look for value for money, they may turn to rental platforms such as peer-to-peer services like By Rotation and My Wardrobe HQ, or to brands’ own programmes offered from department

stores like Selfridges. The market is expected to reach \$2.1 billion by 2025.¹⁵⁹ More than 40 percent of growth is expected to come from the APAC region.¹⁶⁰

Meanwhile, fashion giants like H&M,¹⁶¹ Zalando¹⁶² and Uniqlo¹⁶³ are stepping up their repair services, providing consumers with another option for more affordable and sustainable ways to dress. Selfridges announced in 2022 that by 2030 nearly half of its sales should be from resale, repair, rental or refills.¹⁶⁴

Staying Attuned

For sure, difficult decisions lie ahead for brands as they face their own cost pressures. Input costs increased in 2022, including for transportation, energy and labour.^{165 166} If brands decide to preserve margins by passing on cost increases to customers, they must do so with a deep understanding of the risks, including the potential to lose customers to lower-priced rivals.

Above all, fashion leaders should be especially attuned to the needs of their target customers, identifying changes that can lead to spikes in purchases or curtailed spending, or rapid shifts to different channels, categories or price points. In order to avoid having to increase their share of discounted or off-price products, brands must return to their core value propositions, while taking a laser-focused approach to products; tightening merchandising strategies to focus on bestsellers; developing more responsive methods to react to consumer demand; and increasing speed to market by taking steps such as nearshoring and on-demand manufacturing.



Saks Off Fifth in Florida. Jeff Greenberg/Education Images/Universal Images Group via Getty Images.

Tapestry: Connecting With Customers 'Is Not Just About Price'



Joanne Crevoiserat
Chief Executive, Tapestry

Tapestry chief executive Joanne Crevoiserat successfully steered the US luxury group that owns Coach, Kate Spade and Stuart Weitzman through the challenging pandemic period. Now, she's betting on strengthened customer-centric tactics and offerings to continue capturing discretionary spending, even during global economic turbulence, while keeping the company on track to hit \$8 billion in sales by 2025.

— by Tamison O'Connor

If a brand is going to succeed in today's retail environment, staying close to its customers is more crucial than ever, according to Joanne Crevoiserat, chief executive of Tapestry, the American group that owns accessible luxury brands Coach and Kate Spade and footwear label Stuart Weitzman. Having joined Tapestry from Abercrombie & Fitch in 2019 as chief financial officer of the group, the retail veteran went on to secure the top job the following year, just after the pandemic hit.

Crevoiserat steered the group through the challenging period, pivoting Tapestry's business model to adapt to a new world order: under her leadership, e-commerce sales more than

CONSUMER SHIFTS

tripled to drive 30 percent of the business today. Total group revenue reached \$6.7 billion in 2022, up 11 percent on pre-pandemic levels, with the aim of hitting \$8 billion by 2025.

Now the industry is facing yet another period of uncertainty, as global economic turbulence will likely push customers across the income spectrum to become more discerning. For accessible luxury brands like those in Tapestry's stable, the key is to focus on creating value for the customer beyond pricing, said Crevoiserat. "That value equation is a combination of the quality of the product, the style and the price," she said. "It's not just about price."

The past 12 months have seen the industry trying to figure out what business looks like in a post-pandemic world. How have you approached this at Tapestry? What are the rules for success that have shifted, what dynamics are more or less constant compared with pre-pandemic times?

I think the only constant is change. That's the one thing we've learned. As we embarked on our transformation, which we've been working on the last couple of years, we were asking exactly that question: What do we need to compete in the new world of retail? We were seeing a lot of trends in the market, and we wanted to position the company to win in the midst of those trends.

The customer is moving quickly, both in how and where they shop, and those buying behaviours and preferences, and also how and where they discover brands. Those behaviours are changing,

which requires companies to stay very close to the customer so that you can move with the customer, but also, [understand] what they value. I'm not sure [their values are] changing, but their values are coming to the surface, so they want to align with brands whose values reflect their own, and this sense of authenticity in a brand is critically important.

Consumers today are more omni-connected, so having a digital presence and capabilities to deliver an experience for a consumer that's authentic to your brand and consistent across different channels is also critically important.

Gen-Z is the growth engine of the luxury industry at the moment. What are the most common mistakes that brands make when trying to engage this cohort?

It's a cohort that is very discerning about what is really true about a brand and what isn't. It is so important to really represent your true values and understand where you have the right to play, because it can't be surface level.

The other aspect for this cohort that we're learning [is] their desire for self-expression. They want to express their individuality. This is a place where we're also leaning in. As we've developed and thought about how our brands fit in with their lifestyle, it is really to unlock this self-expression. In fact, as we think about this next phase of growth for Coach, we're moving from what was once called "accessible luxury," which was really about luxury at an accessible price point, to the concept of "expressive luxury,"

where we're more inclusive in our price point, but allowing our consumer to express their individuality through our brands.

The accessible luxury sector is potentially more at risk during a downturn because, when times are tough, wealthy consumers tend to trade up and aspirational consumers tend to trade down, leaving the middle squeezed. How can brands safeguard growth during times like these?

History would show that our space, our brands and our category have been incredibly durable through downturns. I do believe that's related to our positioning and the value we represent in the marketplace.

Over time, handbags and leather goods, the accessories category has proven to be more durable through downturns. This is a space that customers continue to spend, because it doesn't only serve a functional need, it serves an emotional need for consumers. So, in the accessories and leather goods and footwear categories, customers are emotionally tied to the category.

We saw it during the pandemic. In July [2020], when all stores were locked down, one of our best-selling handbags at Kate Spade was a \$348 pineapple handbag. Nobody needed a pineapple handbag, and we talk about it a lot because our product strikes that emotional connection with consumers. It brings them that sense of confidence, that sense of joy as an added part of their wardrobe.

The other thing that we're seeing is the very high end of the market, those traditional European



Coach's Spring/Summer 2022 show at New York Fashion Week. Victor Virgile/Gamma-Rapho via Getty Images.

The State of Fashion 2023

luxury players, are taking prices way up. So the white space for us to deliver value that a customer really recognises in the function and the emotion of that bag and the quality, gives us the room to take price and still maintain that tremendous value that we deliver in the marketplace.

We've developed capabilities and disciplines over the last few years through our data and analytics capabilities, better marketing capabilities and better management overall. We're disciplined stewards of our brands, and we will not resort to driving price down through this. When the consumer's pressured, we're going to stay close and speak to the consumer, deliver the value that they recognise, without relying just on pulling a

price or a discount lever for our brands.

Inflation more broadly has left companies facing cost pressures. Transport and raw material costs continue to rise. That cost is going to be passed down to the consumer if a brand's going to protect margins. Do you see price increases as beneficial or alienating in a tough economic climate?

When you go through a downturn, customers tend to be more selective. When they're more selective, they put their money where they see the value, and that value equation is a combination of the quality of the product, the style and the price. It's not just about price.

I do think that pricing power helps us as a business to be able to absorb some of those cost increases, but we're also very focused on managing our business better to avoid or minimise the cost increases that we see, whether that's our sourcing footprint that allows us to move production around the world, or the work we do in terms of logistics, to try and reduce our dependence on air freight.

How do you see the potential for alternative business models to create new revenue streams or opportunities? Coach is expanding its Reloved resale programme at the moment; how do you see that business evolving?

We've always done repairs and

refinishing and refurbishing work, so it was a natural extension of our history to test this idea of bringing the Reloved product into our stores. We saw a tremendous response, so we've been building those capabilities to make it even bigger.

To scale this opportunity, we're now taking back handbags at all of our retail locations in the US. We're having to hire more leather craftsmen to help refurbish and repair because the volumes are going up. We started an apprentice programme, to help build and train new craftsmen in this space.

Interestingly, it has also informed a new business model that we're pursuing, called Coachtopia. It is a completely circular business model, and we're building product in Coachtopia with circularity in mind from the beginning.

There are new techniques in terms of bringing this product to market with full circularity in mind. Regenerative agriculture; we're using and leveraging sustainable materials, including regenerative leather; but also techniques in terms of making a handbag with consideration for end-of-life "unmaking" of a handbag. As we learn about those techniques through Coachtopia, we can bring them into the main brand and make it better and more sustainable.

Off-price businesses can boost sales but, equally, they have the potential to damage brand equity and cannibalise the full-price business. How should companies approach off-price amid this challenging macroeconomic climate?

It depends on how you manage it. If the off-price business is just discounting regular-price product, I fully agree with your thesis, that it could be brand damaging. The way we think about our outlet channel is, frankly, less of an off-price business. In fact, we've spent the last couple of years refining and differentiating the product in each channel, and we're very focused on delivering value within that outlet channel that a customer recognises.

In many ways, it's a different customer. This was part of our focus on the customer, it's embracing the customer that is shopping in these channels and understanding what they value, and bringing them the style, the quality and the functionality that drives the business. We have to do that at the low end of our business all the way through the high end of our business, and we want to be as proud of that business as we are at the top end.

Brands can maintain a healthy outlet channel business if they keep the consumer at the front of what they do, and they're not just competing on price; that they're delivering tremendous value product that they can be proud of into the marketplace at that price point. Delivering value and differentiating that from the high-end product. It could be materials, it could be silhouette, it could be level of functionality, level of style. Really, running the business as an important business in and of itself, is critical.

China is a crucial market for the luxury industry but the outlook for the market is so unclear, with ongoing disruption due to the

country's zero-Covid policy. How can brands navigate this?

We've been in China for over two decades, and the one thing that has been incredibly consistent over time is the resilience of the Chinese consumer. What we're seeing today is disruption caused by this macro outside force where customers are constrained in a way that they can't get out and shop. But what we saw after the last lockdown was the Chinese customer came back much stronger than they had even pre-Covid. These lockdowns have been more inconsistent in terms of different cities at different times, so it's been choppy, and we do expect that the recovery will be more gradual this time, but long term, our thesis on China, we remain very confident. It has not changed. We continue to see growth in China.

Our brands are targeting a very large middle class, and that cohort will continue to grow, and it's a consumer who values Western brands generally.

This interview has been edited and condensed.

04. FLUID FASHION

Gender-fluid fashion is gaining greater traction amid changing consumer attitudes towards gender identity and expression. For many brands and retailers, the blurring of the lines between menswear and womenswear will require rethinking their product design, marketing, and in-store and digital shopping experiences.

KEY INSIGHTS

1. Interest in gender-fluid fashion is driven by younger generations, particularly Gen-Z consumers, who see their gender identities as less static than their elders. Around half of Gen-Z globally have purchased fashion outside of their gender identity.
2. The shift is visible not only on high-fashion runways but also in everyday shopping, with online searches for “genderless” and “gender neutral” fashion increasing year on year.
3. Younger consumers are more likely to shop across gender lines, and consumers in North America, Europe, Japan and South Korea, among other locations, are expected to be the most receptive to gender-fluid strategies from fashion brands.

EXECUTIVE PRIORITIES

- | | |
|---------------------------|--|
| Know your audience | The extent to which brands lean into gender-fluid fashion will depend on their customers’ demographics, particularly age and the cultures of the markets in which they operate. |
| Think holistically | Introducing gender fluidity into strategies and product collections requires updates to business processes and daily operations, from product design to merchandising to marketing to in-store design. |
| Avoid tokenism | Leaders should cultivate diverse workforces that can understand the discourse. They should also avoid tokenistic projects that lack authenticity. |

CONSUMER SHIFTS

Emboldened by the celebrities and designers they admire, a growing number of consumers are buying across gender-specific categories.¹⁶⁷ Silhouettes, fabrics and colours no longer need to conform to traditional dress codes to sell to these consumers. For brands, the shift may be at an inflection point, prompting industry leaders to consider how to best act on changing consumer expectations.

Gender has long influenced fashion and, even amid the shift to casualisation, gender is embedded in today’s merchandising practices. Introducing gender fluidity into product collections therefore may require a practical update of operational systems that have been used in the fashion industry for decades. A garment’s size, fit and shape determine the key differences between menswear and womenswear, but there are subtler distinctions too. Buttons largely continue to appear on different sides of men’s and women’s shirts, for example, a practice thought to stretch back as far as the Renaissance when upper-class women were dressed by servants, but upper-class men dressed themselves.¹⁶⁸

The shift towards gender-fluid fashion is partly driven by evolving cultural and social attitudes towards gender in different regions and across generations. In recent years, many people have developed a greater acceptance and understanding of sexual orientations and gender identities, with younger generations today often viewing gender identity as a spectrum, rather than a binary.

Examples of these attitudes are even discernible in many countries or regions where gender inclusivity and sexual inclusivity are less established. For instance, in Kenya, local labels such as Vivo and Sevaria are creating collections based around gender-inclusive designs and working with fabrics that traditionally appear only in womenswear, such as silks, but for menswear.¹⁶⁹

Exploring New Categories

“Gender neutral is not a trend, it’s a reality,” said Jonathan Anderson, creative director of Loewe and founder of label JW Anderson, in 2021. “My whole philosophy is that you cannot tell people what to wear. You’re not allowed to say: I want this to be bought by a woman or by a man.”¹⁷⁰

According to research conducted by fintech company Klarna, around 50 percent of Gen-Z globally have purchased fashion outside of their gender identity, and around 70 percent of consumers say they are interested in buying gender-fluid fashion in the future, with younger generations leading the way.¹⁷¹

Another survey found that Gen-Z respondents under 20 years of age are more likely to buy products that were not designed specifically for their gender, with 56 percent of the cohort stating they buy clothing that is not classified by gender at all.¹⁷² This viewpoint will likely become more prominent in the market given that Gen-Z will soon become the largest cohort of consumers globally. (In the US, Millennials outnumbered Baby Boomers in 2019; Gen-Z consumers are expected to surpass Millennials in 2036.¹⁷³)

The combination of shifting attitudes and pop culture influence has boosted consumer demand for gender-fluid fashion. On the fashion app Lyst, searches for terms including “genderless” and “gender neutral” increased 33 percent in the first half of 2021.¹⁷⁴ In South Korea, the number of posts about genderless fashion more than doubled in 2020 on search engine Naver.¹⁷⁵ This shift is already translating into sales, as can be witnessed in handbags, a category that traditionally caters to women. Luxury resale site The RealReal reported growth in interest for Birkin bags has grown twice as fast among men than women, and resale marketplace StockX said there is an even split of men and women among consumers shopping within its handbags section.¹⁷⁶

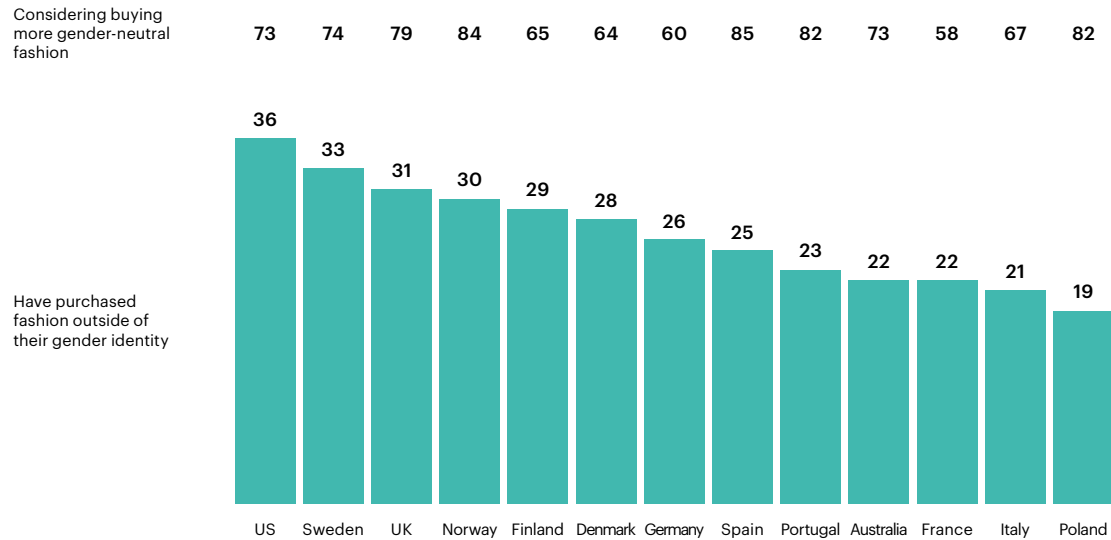
Luxury and designer fashion labels have

CONSUMER SHIFTS

Exhibit 10:

Consumers across the globe are shopping for fashion across the categories of womenswear and menswear, with US shoppers leading the way

% of respondents



Source: Klarna Insights survey in cooperation with Dynata

embraced their own versions of gender-fluid fashion by casting androgynous models or dressing masculine models in feminine looks — and vice versa. In fashion capitals, some labels have explored gendered expectations in their recent casting and styling of runway shows: Raf Simons styled male models in dresses and nail polish, while Maison Margiela sent male and female models down the Paris runway in skirts and high-cut boots. Meanwhile in New York, emerging labels like Private Policy and Eckhaus Latta present gender-fluid collections each season with a diverse cast of models.¹⁷⁷ The shift can also be seen in footwear: Christian Louboutin has released a capsule

collection featuring high-heeled boots in men's sizes.

Embracing gender-fluid fashion can be complex, especially when taking cultural differences across markets into consideration. Fashion leaders can consider creating diverse workforces to help strengthen their understanding of the discourse and ensure companies avoid tokenistic projects which may be perceived as lacking sincerity or authenticity. Brands and retailers could also train store associates to help customers shopping across gender lines find the right fit, with an understanding of how sizes translate across gendered items.

Aligning gender-fluid fashion with how

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consumers conceive of gender is critical. In the past, some brands have responded to changing norms by introducing a third, distinct “unisex” category, often with smaller assortments of oversized, minimalist clothing. A number of commentators have criticised these attempts for being “dull” or “baggy” and lacking in authenticity.¹⁷⁸ While unisex fashion has been around since the 1960s,¹⁷⁹ having a unisex line today may not be precise enough to serve younger generations’ perspectives of a gender spectrum.¹⁸⁰

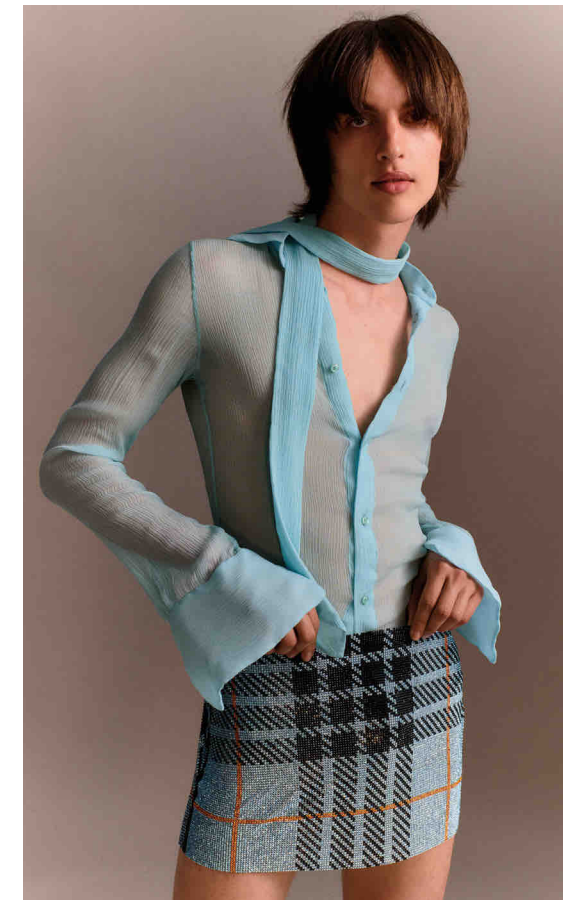
As fashion leaders seek to meet the demand for gender-fluid fashion in 2023, they should consider how they may evolve their marketing, product design, store design and merchandising.

As fashion leaders seek to meet the demand for gender-fluid fashion in 2023, they should consider how they may evolve their marketing, product design, store design and merchandising. One factor is fit, given that sizing conventions in the fashion market are established along gender lines. Even brands that have embraced gender-fluid clothing, like Gucci, still design some of those items based on women’s or men’s sizing conventions.¹⁸¹ Brands that commit to offering gender-fluid fashion can develop new sizing charts, which address a wider range of customers. Retailers with brick-and-mortar networks can also address challenges around fit by offering in-store alterations or made-to-measure designs.

Modernised merchandising techniques can help brands sell products to a wider range of customers. Online luxury boutique Ssense, for example, presents men’s pieces in its womenswear offering based on “cut, fit, size or styling,” according to Brigitte Chartrand, its senior director of womenswear buying.¹⁸²

Other brands have removed gender

categories for all or parts of their collections.¹⁸³ New York-based label Phluid Project does not segment its clothing by gender, and creates designs using a custom sizing model.¹⁸⁴ Uniqlo designed a “Made For All” collection that was merchandised in with men’s and women’s collections, both online and in stores.¹⁸⁵ Resale platform Depop does not filter its inventory by gender unless customers opt for it, and recommends products based on a shopper’s past purchases instead of gender categories.¹⁸⁶ These strategies offer shoppers options to choose to navigate gendered categories as they wish, and consider more products to purchase than they might have otherwise.



A look from the Ludovic de Saint-Semin Autumn/Winter 2021 collection. Ludovic de Saint-Semin

Starting Small

Brands that decide to make more space for gender-fluid collections could start with small changes that target their most receptive customers first. Younger shoppers, especially those under 20 years old, are the most likely to seek out and shop across gender lines. Marketing can be adapted accordingly, through casting and campaign images. When Uniqlo announced its 2022 collaboration with Marni, for example, its campaign featured men and women wearing a mix of pieces from across the offering.¹⁸⁷

Younger shoppers, especially those under 20 years old, are the most likely to seek out and shop across gender lines.

Some geographies may have a ready customer base, like North America, Europe, Japan¹⁸⁸ and South Korea,¹⁸⁹ where perceptions around gender identity in fashion are more nuanced.

Fashion companies can consider the many ways in which they already interact with customers seeking gender-fluid products and use those points of contact as learning opportunities. Brands that offer cosmetics and fragrances can also share learnings with their fashion teams. Gender-fluid fragrances represented 51 percent of all fragrance launches in 2018, up from 17 percent in 2010,¹⁹⁰ and more than 50 percent of men today say they use facial cosmetics.¹⁹¹

Customer focus groups or employee taskforces can help brands hone their understanding of what gender-fluid products their existing customers want to see. Collaborations are another way to test gender-fluid products, especially for larger brands that want to learn from smaller ones that have more experience catering to customers across gender lines. When Calvin Klein

collaborated with Palace in 2022, for example, the collection of oversized denim, sweatshirts and underwear was not categorised by gender.¹⁹²

Similarly, brands can trial different merchandising approaches in stores and online, removing or mixing gender categories and observing how customers shop differently.

After building a foundation of knowledge and product testing, companies can progressively integrate gender-fluid products and strategies across their businesses. From the design process to major seasonal campaigns and store design, brands can tap a range of strategies to modernise their approaches and evolve ideas around gender norms. These shifts will likely only become more important as Gen-Z consumers mature — and their purchasing power grows.

How Gen-Z is Propelling Gender-Fluid Fashion

Younger consumers have been pivotal in breaking down barriers to greater acceptance of non-binary gender identity, including how it is embraced in fashion. For these consumers who value freedom to express themselves, they expect to influence and be influenced by brands that in many respects normalise gender-subverting fashion.

by Robert Cordero



When Timothée Chalamet wore a bright red, halter-top, slimly cut jumpsuit at the 2022 Venice Film Festival, the 26-year-old movie star — and his outfit designed by Haider Ackermann — turned heads. As gender-subverting couture goes, this was yet another memorable moment. Chalamet has essentially become the poster child for young generations that are using fashion to assert their freedom of expression, often by disregarding

conventional gendered stereotypes.¹⁹³

It's a cultural shift for which Gen-Z can take much of the credit. Born between the mid-1990s and the 2010s, this generation has been vocal — most often on social media — about their opposition to being pigeonholed into a binary world of male and female.¹⁹⁴ “Our generation has dismantled the idea that gender is a male and female binary,” said 22-year-old Nate Jones, head of talent at

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Juv Consulting, which advises companies on connecting with Gen-Z. “I think clothing is just one area that’s inevitably going to be touched because it’s [essential to our every day] and [shopping] is still mostly a gendered experience at this point.”

Even veterans of fluid fashion design are seeing Gen-Z’s influence. “I think in the last few years, things have changed a lot,” said designer Alejandro Gómez Palomo, who founded gender-neutral label Palomo Spain in 2015. “You can see now a skater with nails painted in pink, wearing a crop top and a pearl necklace, and he’s [a] completely straight boy. ... [A few years ago] it would be, like, ‘only for the gays, only for that community that I’m part of.’”

Across the fashion industry, it signals a significant pivot. Gen-Z now holds great sway over key parts of the fashion industry. Not only is Gen-Z the largest generation ever — at 25 percent of the global population — but it also has spending clout: In the US alone, Gen-Z consumers have an estimated purchasing power of \$360 billion, according to BoF Insights, the research and analysis arm of BoF.¹⁹⁵

Gen-Z may not be seeking out gender-neutral fashion explicitly, but choosing to interact with brands in a less restrictive way than generations past.

But as brands and retailers are discovering, changing their gender-specific shopping experiences and building a fluid-fashion offering that resonates with this generation is far from straightforward. In particular, Gen-Z’s relationship with gender-neutrality in fashion can be nebulous at best. For example, the generation is not necessarily seeking out gender-neutral garments — Gen-Z prioritises other factors such as affordability when purchasing clothes.¹⁹⁶ However, Gen-Z cares about inclusivity and having the freedom to shop across fashion’s gendered categories, showing more willingness to wear garments designed for another gender.¹⁹⁷ As

such, Gen-Z may not be seeking out gender-neutral fashion explicitly, but choosing to interact with brands in a less restrictive way than generations past.

As Juv’s Jones put it: “When I’m making any buying decision, first and foremost, I think about how it looks, then I think about the quality, and I think about the price of what I’m buying.”

Igniter of Trends

Just a generation or two ago, the world was different. And so were attitudes about gender fluidity. But as Gen-Z began growing up, change was afoot. By 2016, a study from marketing communications agency Wunderman Thompson found that 56 percent of Gen-Z consumers shopped for clothes across genders.¹⁹⁸

In the same year, Jaden Smith, then 17 years old and now a Gen-Z style icon, starred in a global campaign for Louis Vuitton wearing a skirt from the label’s women’s collection.¹⁹⁹ From then on, independent brands began capturing more attention for their gender-fluid messages, including Hood by Air — which was ahead of its time when Raul Lopez and Shayne Oliver launched it in 2007 — along with Palomo Spain, Ludovic de Saint Sernin and Telfar. As a broader shift towards casualisation took off, streetwear got in the game too. Wardrobe essentials began to include streetwear items that were not assigned to a gender, including roomy hoodies and mini cross-body shoulder bags.

Gen-Z has inspired and been inspired by a number of role models, ranging from beauty influencer Bretman Rock, who shot to YouTube fame as a teenager in 2015, and gender non-conforming designer Harris Reed, who was recently appointed Nina Ricci’s creative director. For the role models, wearing gender-neutral clothing, or dressing in a gender-fluid way, is not as radical as perhaps it was for their parents. It’s just part of how they see the world and how they want to live in it.

Gen-Z is translating this into fashion in unique ways. Increasingly, they see themselves as co-creators, playing an active part in the ideation of new styles, rather than waiting for brands to

IN-DEPTH

show them what the next big trends are. Steve Dool, brand director of social e-commerce company Depop told BoF Insights: “This generation is more likely to gain inspiration from their peers and who they see online, versus the top-down fashion system that has been the default trend driver for previous generations.”

Now, trends often start on social media platforms like Instagram, TikTok and BeReal. “Coastal grandmother,” a look inspired by actor Diane Keaton’s menswear-infused style — harking back to her wardrobe in films like “Annie Hall” (1977) and “Something’s Gotta Give” (2003) — became a cultural phenomenon in 2022.²⁰⁰ It was not started by a magazine or a brand campaign, but by TikToker Lex Nicoleta.

Several hashtags on TikTok now organise user-generated videos featuring gender fluidity or gender neutrality, such as #femboy, which has garnered more than 3 billion global views as of the end of October 2022. Meanwhile, #genderneutralfashion has had over 316 million views, #genderneutral over 223 million and #mascgirl over 66 million.

Brands Respond

For much of the past decade, brands have been experimenting with understanding what does and doesn’t work in fluid fashion shopping experiences across different price points. At Palomo Spain, for example, Gómez has been on a multi-year journey as one of the first high-end genderless labels to get noticed by the industry and get the label onto shop floors. Department stores initially struggled to figure out whether to display Palomo Spain’s clothing in the women’s section, men’s section or both. In the end, men’s sections prevailed for Palomo Spain. The stores then also sought changes to accommodate female customers. “It was really hard for us as well to change the patterns and the shapes and everything because [the stores] wanted [garments] for girls and in a smaller size,” he recalled, adding that he did not want the label to be pigeonholed. “I make clothes that everyone can wear. ... I like playing with masculine/feminine

all the time and that tension, of course, attracts womenswear clients and menswear clients.”

With wholesale channels, the brand has had to find a gender-specific middle ground, catering to male and female customers differently. With more men than women shopping on its website, Gómez started organising pop-ups and opened the Palomo Spain studio in Madrid for women, having found that the vast majority of the brand’s female customers prefer trying on garments.

Another fashion brand that has confronted the practical issues of fluid fashion is Eytys. Founded by Jonathan Hirschfeld and Max Schiller in 2013, the Stockholm-based brand started by selling thick-soled unisex sneakers before branching out into clothing, online and in three stores — two in Stockholm and one in London.²⁰¹ “Unisex has always been a given for Eytys’ products. It felt natural for us. We see it as a service, the customer chooses,” Schiller said. “As our collections grew it made sense to continue with a unisex philosophy for all products to not limit our customers.”

The company now merchandises collections in its physical stores based on looks, not on gender. On the Eytys website, its products, which are often available in extended size runs and come with detailed size charts for all body types, are photographed both on male and female models who reflect the racial diversity and various identities of its customers.

Schiller conceded that the company’s business model may have been easier to execute with separate menswear and womenswear categories because of the challenges posed in production, merchandising and marketing. But, “we can now see that the efforts and the costs associated with the complexity are starting to pay off,” he said. For example, he noted that the brand’s Benz jeans, Eytys’ take on the 1990s baggy jean, is bought equally by customers who identify as male and female, while boots and dress shoes that were primarily bought by female customers are attracting male customers too. Its Gaia boots, which come with high heels in EU sizes 43 to 45, are “always out of stock,” he added.



The State of Fashion 2023

YouTube/Breiman Rock, Gotham/CCI Images via Getty Images.

This fluid-fashion trajectory is not lost on retailers either. UK department store Selfridges, for example, has been buying extended-size runs from brands if they are available, which accommodate male, female and non-binary body shapes. The retailer also places both male and female mannequins in each department. “Our approach is to make the shopping experience as natural as possible,” said Sebastian Manes, merchandising and buying director at Selfridges.

Mixing and Matching

The industry is also approaching marketing differently, often putting greater emphasis on inclusivity generally than on gender neutrality. Craig Brommers, chief marketing officer of popular Gen-Z brand American Eagle Outfitters, explained on a recent webinar that the brand intentionally keeps briefs for photo shoots “loose” so that

creatives have the leeway to mix genders and styles as they see fit.

Brommers added that AEO has decided not to explicitly market itself as a gender-neutral brand. “Right or wrong, we are not out there pounding our chests about this because we feel that this is an individual choice, and this is naturally happening,” he said. “I think there are other brands that are talking this up more ... [but] what we are saying: you be you and we’re happy for you to be you.”

In many respects, Gen-Z sees gender-fluid fashion as being about more than just products. “We’re thinking about the brand or company we’re buying from, the team it’s coming from, the faces behind and in front of the camera, and all that goes into getting that product out the door,” said Juv’s Jones. “Our buying power is only growing, and we’re only ageing into the market. And so I think it’s important to meet [us] where we are.”

05. FORMALWEAR REINVENTED

Formal attire is taking on new definitions as shoppers rethink how they dress for work, weddings and other special occasions. While offices and events will likely become more casual, special occasions may be dominated by statement-making outfits that consumers rent or buy to stand out when they do decide to dress up.

KEY INSIGHTS

1. After two years of decline, the formalwear category rebounded in 2021 and 2022. That momentum will continue into 2023 but could slow amid a tough economic climate.
2. Formalwear for special occasions is expected to be the most promising part of the category: 39 percent of fashion executives expect sales of occasion wear to be among the top three growth categories in 2023.
3. Rental will present a unique opportunity: consumers are more likely to rent men’s and women’s formalwear than any other apparel or accessories category.

EXECUTIVE PRIORITIES

Understand use cases	Gather insights on post-pandemic consumer habits to identify how formalwear fits into their new routines and requirements.
Focus assortments	For brands catering to office wear and evening wear, offer “power casual” or “smartorial” hybrid styles and separates that bridge different use cases. For brands catering to special occasions, emphasise statement pieces.
Break boundaries	Encourage creative teams to reimagine the formalwear category with as much diversity in terms of colours, shapes, products or materials as any other category.

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Not so long ago, people segmented their wardrobes for leisure activities, business events and family celebrations. But now, the lines between the dress codes for many of these occasions have blurred, leaving fewer events that require what was traditionally considered formalwear, such as suits and long dresses.²⁰²

As a result, differences in preferences for the clothes people wear at offices and evening events as opposed to upscale, special occasions, are becoming even more pronounced. For day-to-day wear, “smart” or “power casual” are the dominant styles, characterised by versatile clothing that can be dressed up or down.²⁰³ And when customers do dress formally, many are embracing more creative styles, choosing unconventional fabrics, bold colours and statement pieces that stand out in their wardrobes and on their social media feeds. Though these dress code shifts are playing out across gender categories, the evolution may be more visible in men’s assortments and merchandising, as the relevance of traditional suiting declines.

As these dress codes crystallize, brands across the market may have a unique opportunity to guide customers towards new products, materials and shapes that reflect modern lifestyles.

On the Rebound

While the size of the formalwear market is difficult to measure due to the breadth of the category, the space can be divided into three groups: office wear, including business suits and smart footwear that are worn in workplaces; evening wear, or smart casual and cocktail attire, like dresses, heels and blazers; and occasion wear, such as the tuxedos and gowns worn at special ceremonies or celebrations.

Formalwear is showing signs of a rebound after pandemic-induced disruptions. In Europe and the US, retail sales of shirts and blouses, non-denim trousers and skirts are projected to grow at a faster rate between 2022 and 2026 than they had in the 10 years before the pandemic, according to Euromonitor.²⁰⁴

But concerns of economic gloom that may be on the horizon may hold the market back in 2023.²⁰⁵ For office and evening wear, this may mean consumers start repurposing garments for multiple occasions. In contrast, occasion wear at the most formal end of the category is expected to be more resilient, reflecting some of the patterns apparent during previous recessionary periods, like that of the early 1980s, when American department stores reported that high-end evening clothes were among the only categories that remained in relatively high demand.²⁰⁶

According to the BoF-McKinsey State of Fashion 2023 Survey, 39 percent of fashion executives expect sales of occasion wear to be among the top three growth categories in 2023. Meanwhile, fewer executives see opportunities for office wear, with 27 percent stating they expect business attire to be among the top three categories set to grow next year.

Putting Fashion to Work

Even before the pandemic and the hybrid-working paradigm of today, office attire was relaxing. Hoodies, jeans and sneakers became increasingly acceptable in many offices. Even banks and professional services firms — with entrenched suit-and-tie cultures — have acknowledged that office dress codes need modernising.²⁰⁷ In 2019, Goldman Sachs announced a firm-wide flexible dress code, encouraging employees to use their judgment when deciding whether they should, or should not, ditch their suits for a more casual look.²⁰⁸

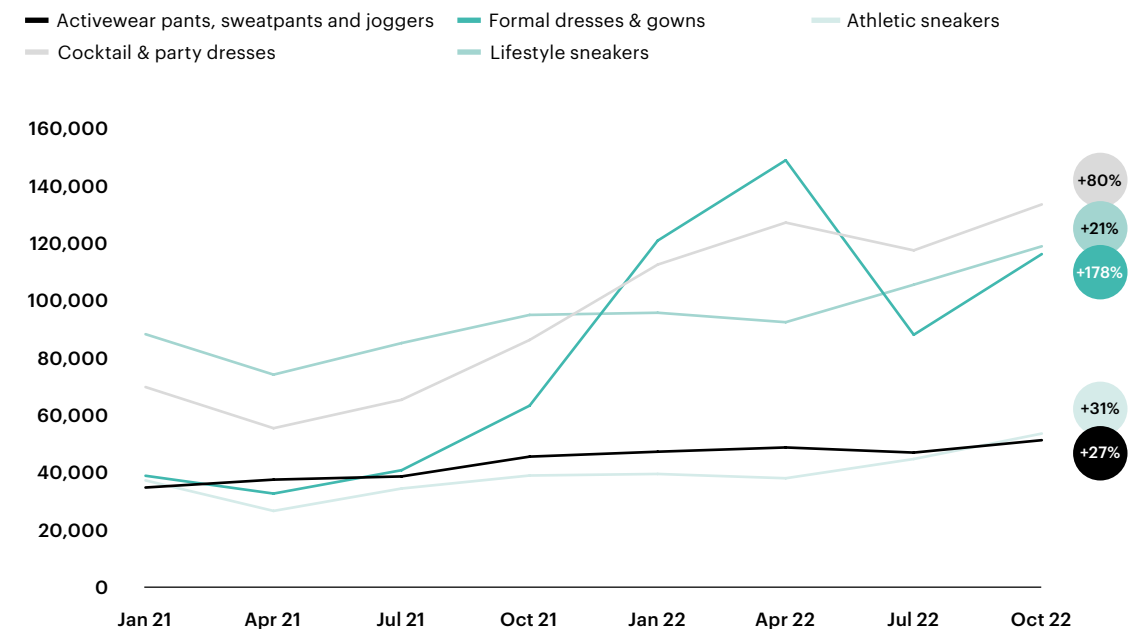
In women’s wardrobes, where dresses have long ruled both office and evening wear, a new take on the pant suit emerged in 2022. Labels such as J.Crew and The Frankie Shop showcased oversized suits and trousers in soft materials for customers looking for polished, fashionable but comfortable styles. Workwear label M.M. LaFleur has honed its “power casual” category of structured knit tops and washable twill trousers. The brand said

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Exhibit 11:

The number of occasion dresses available to buy in the US has boomed over the past year as consumers return to dressing up

Number of products available by category in the US, January 2021–October 2022



Source: StyleSage

in early 2022 that its power casual styles were generating triple the sales of dresses that used to drive about a third of the company’s sales prior to the pandemic.^{209 210}

In the men’s market, brands that traditionally focused on formalwear for work and evening are rethinking old approaches to keep up with changing consumer tastes. Italian luxury label Zegna produced a relaxed take on daily attire in its Autumn/Winter 2021 campaign, which it calls “luxury leisurewear,” offering versions of its signature tailoring in jersey knits and other soft fabrics.²¹¹ Similarly, labels like Kiton and

Brioni have effectively shifted their focus from traditional work wear and suits towards hybrid pieces that can function well across activities — a style some are calling “smartorial.”²¹² Consumers are updating their wardrobes to reflect these blurred lines between leisure wear and work wear, with worldwide Google searches for “smartorial” doubling between January and September 2022.²¹³

Apparel with hybrid details that bridge formal and casual attire — such as formal cuts in comfortable materials that often incorporate performance fabrics, like sweat wicking or stretch — are also in high demand. For example, cashmere

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joggers from Burberry and Loro Piana or linen and crocheted shirts from Jil Sander and Jigsaw can be dressed up or down depending on the occasion.²¹⁴

Retail sales of shirts and blouses, non-denim trousers and skirts are projected to grow at a faster rate between 2022 and 2026 than they had in the 10 years before the pandemic.

Wherefore the Black Suit

Where does the shift in workwear leave suits? The popularity of suits was already declining before the pandemic, especially in the US, Western Europe and Latin America. In the UK, spending on men's suits dropped from £377 million (about \$425 million) in 2019 to about £240 million in 2021. In March 2022, the UK's Office for National Statistics removed men's suits from its basket of goods to calculate the cost of living for the first time since 1947.²¹⁵

Suit makers Hugo Boss and Brooks Brothers have relaunched their brands with a focus on athleisure and upscale streetwear.²¹⁶ Other suit makers are pivoting from black and grey to suits in bold colours. On London's Savile Row, the likes of Anderson & Sheppard and Edward Sexton have reported an increase in sales of colourful suits and those in lighter fabrics. Black suits represented 25.8 percent of suits for sale online between September 2018 and September 2019, compared with 19.3 percent between September 2021 and September 2022, according to retail tracking firm Edited.²¹⁷ Pink, green and orange are among the more popular new hues.

The dress code shift also translates to customers buying separates rather than two- or three-piece suits. "We have noticed that the customers who always bought a suit from Zegna and Tom Ford are now buying separates from the

same brands," said Dean Cook, head of menswear buying at British department store Browns. "The brands are also aware of this and have diversified their [offerings], appealing to a customer who is maybe working from home with the necessity for something smart but with a different aesthetic."²¹⁸

With this, suit prices are declining. In the UK, the average price for a suit fell 75 percent year on year in July 2020 to approximately £200 on average, according to trend forecasting company WGSN.²¹⁹

To be sure, a traditional, structured suit still has a place in modern wardrobes, but in many parts of the world, its use is confined to a smaller selection of formal occasions. In the Middle East, black suits remain popular in day-to-day dressing, as well as in Asia: in China, suits have recently become symbols of job security for some.²²⁰ But in many cases, traditional suits can no longer merit the entire focus of a fashion business.

Making a Statement

Unlike for office and evening wear, when customers dress up for the most formal occasions versatility and comfort are expected to become less of a factor in purchase decisions. Instead, shoppers may look for statement-making and unique items that will stand out, making occasion wear a ripe space for higher-end, specialised brands that can meet the desire for playful indulgence. For example, Elie Saab is among the brands now offering made-to-measure or couture suits for men to capitalise on a growing business for creative and personalised attire.²²¹ Meanwhile, UK-based department store chain Flannels has opened a tailoring hub that allows shoppers to buy pieces made to order, as menswear silhouettes move beyond streetwear to a more tailored look.²²²

The shift is visible in women's apparel and footwear, too. The number of cocktail and party dresses as well as formal dresses and gowns for sale in the US between January and October 2022 increased by 80 percent and 178 percent respectively

05. FORMALWEAR REINVENTED

compared to the same period in 2021, according to market intelligence platform StyleSage.²²³ Searches for platform heels have spiked 75 percent between 2021 and 2022.²²⁴ At luxury retailer MyTheresa, growth in shoe sales has been driven by parties and other occasions,²²⁵ with popular brands including Amina Muaddi, whose sought-after avant-garde square-heeled shoes have helped the company grow into a \$55 million brand.²²⁶

Meanwhile, dresses have also garnered attention at more accessibly priced retailers. Asos reported sales of 100,000 party dresses in 2021.²²⁷ Abercrombie & Fitch added a "best dressed guest" category to its website in 2021, helping it to sell more dresses than ever before in the brand's history.²²⁸

For occasion wear, many customers will rent special pieces they do not anticipate wearing more

than a few times, or turn to resale platforms to source luxury items. The rental market is projected to be worth \$2.1 billion by 2025, with growth driven in part by demand for elegant outfits.²²⁹ According to a 2022 Kantar survey, shoppers were more likely to rent men's and women's formalwear than any other apparel or accessories category.²³⁰

Two Diverging Markets

As brands navigate dress codes and expectations around formal attire, they may need to rethink their assortments to address two markets: versatile, polished but casual everyday apparel and statement-making special occasion attire. Brands can take into account how use cases drive shoppers to make purchases; consumer surveys and focus groups should be essential to understanding changing preferences and reflecting those desires in design and merchandising strategies.

Brands that want to cater to office and evening wear should consider how, across the market, shoppers will increasingly turn towards multi-purpose wardrobe staples that balance an upscale appearance with comfort and ease. These types of separates will likely be easily mixed into a variety of dress codes, offering a range of casual to relaxed formal combinations. Merchants and marketers should message multi-purpose pieces carefully, so shoppers understand their range and versatility.

Designers that seek to serve special occasion wear, however, can deprioritise versatility and invest in differentiating their collections to excite customers when they are ready to swap their soft separates and athletic apparel to buy — or rent — something more memorable.



A Zegna Autumn/Winter 2022 look. Zegna.

Hugo Boss: Reclaiming the Formalwear Space



Daniel Grieder
Chief Executive, Hugo Boss

The decline of the office and the casualisation of wardrobes made for tough going during the pandemic for office wear and formalwear players. But Hugo Boss CEO Daniel Grieder sees a bright future for the category as tailoring sales rebound.

— by Robert Williams

When Daniel Grieder was named chief executive of German apparel maker Hugo Boss AG in June 2020, the outlook for the brand's core suiting and office wear was shrouded in uncertainty — the appointment came during the height of the pandemic, when the return to in-person work and events looked extremely far-off.

But by the time he officially took the reins of the company a year later, signs of hope had started to spring up as demand for occasion wear came roaring back with the lifting of Covid-19 restrictions around the world. Clients' flexible lifestyles sparked demand for comfortable, contemporary tailoring — with some customers seeking blazers and trousers cosy enough to wear at home, to the

CONSUMER SHIFTS

office, or to coffee and yoga.

Boss rolled out a revamped visual identity, updated its marketing message and started mixing in tailored pieces with a streetwear-infused casual offer that sought to recontextualise work attire as an opportunity for individual empowerment rather than promoting a neutral business uniform. "Be your own Boss" has been the slogan on ads with a new cast of celebrity spokespeople, including Kendall Jenner, Khaby Lame and Matteo Berrettini.

In 2022's second quarter, sales at Hugo Boss rose 29 percent above 2019's pre-pandemic levels as the company targets doubling annual revenue to over €4 billion (approximately \$4 billion) by 2025.

Casualisation and the decline of the office have led to some really challenging years for formalwear. A lot of people who used to have two separate wardrobes now only need one. Has that meant clients are spending less, or simply shifting the spend to different categories and price points?

Before Covid, tailoring [already] became a bit more smart-casual. It became more comfortable, fewer ties, more relaxed but still a blazer and pants. That was the trend. Then Covid came and everybody said, 'Suiting, tailoring is out; nobody is going to wear it at home.' In the beginning, that was clearly the case.

However, when we slowly came out of the pandemic and events started to resume, we were impressed by how fast the swing back to suits actually happened.

With what kinds of suiting is Boss seeing that momentum? It doesn't feel like people just

went back to dressing how they were before.

The suiting for occasion wear continues to be more traditional, wearing a suit nearly [always] with a tie like before the pandemic. And the demand for that is much bigger than we expected.

Then for [everyday] suiting, we needed to continue [to be focused on that]; at Boss it's in our brand DNA. We had to try to develop the suit of the future, a suit that is probably more comfortable, that is maybe a bit more technical.

We call it "dressletic." We were looking at how so many people when they take a plane wear an Adidas tracksuit. We thought [tracksuits] is not our DNA, but that comfort, if we can bring that into a suit, it would be incredible.

It sounds like that would respond to people wanting more options for day-to-night dressing: a suit you could wear, say, on a day when you're going to pop into the office for a meeting, but also go for drinks.

People want to dress up after the pandemic. It's a clear trend that they want to dress up in a smart-casual way, but they don't want to wear something that is not comfortable anymore.

So we put a lot of effort into this performance suiting — that's stretch, it's water resistant, you can go on a plane in it, it's wrinkle-free, it's light, it's [worn in] sunshine or rain. People don't just go to the office [in it]; it's so comfortable that you nearly do not want to wear anything else. It's more comfortable than jeans, it's more comfortable than anything.

This performance suiting that we now offer in our stores is sold out

every day. It's the supply chain that is our biggest issue, to even be able to deliver on that demand.

Do you see demand varying among age groups? During fashion weeks [in 2022], we've seen a lot of the very young influencers and TikTokers wearing suits who just a few seasons ago would have all been in hoodies and sneakers.

It's true that with Gen-Z, we are selling suits again but in a very modern way, that could even have side pockets on the pant or the jacket is shorter. It's maybe even a bomber jacket you wear with the pants.

With Millennials, it's a bit more casual. That hoodie [from our campaign] was the best-selling item we ever had. It's sophistication, but still something more casual or smart-casual that is well received.

Older consumers are dressing more traditionally and probably these are the ones that love the occasion dressing most. However, they are open to more comfortable materials.

How has the return to more formal dressing impacted footwear? Are most people excited to pick up a fresh pair of brown shoes or high heels again or is the momentum still focused on sneakers?

Sneakers are definitely the big trend. It's an endless boom.

To be honest, brown shoes are still going down, except for occasion dressing, and even there, if you mix in something new, it's probably a more casual shoe.

One priority you've set for Boss is to boost its share of womenswear, and you



The State of Fashion 2023

Khaby Lame for Hugo Boss. Hugo Boss.

recently tapped some major womenswear stars like Kendall Jenner and Hailey Bieber as spokespeople. What sort of impact is that having?

We wanted to reintroduce Boss as a new name [separate from “Hugo”], saying, ‘Everybody can be a boss, as long as you stand for something; as long as you do something, as long as you be your own boss.’ It doesn’t matter if it is a man or a woman. Suddenly Boss was relevant in the womenswear business again, as well as for young consumers.

Currently women do want to wear a dress, they want to wear a suit, but it has to be comfortable.

It has to be maybe an oversized suit, maybe also in more colours.

Where is the price sensitivity headed for tailoring? People, especially men, used to be willing to pay so much for suits because they would wear them almost every day to the office. If tailoring is being framed as more of a fashion and lifestyle piece, will that change how much people spend?

It depends on the target group. The demand is here for both [luxury and accessible luxury]. Where I think it’s under pressure is the mass market. When you buy a suit, you want to have a suit that

is from a brand that is known as a suit brand. And if you are a brand, that also shows the consumer you think about sustainability, they’re willing to spend more. We are upgrading more often than downgrading in terms of pricing, but it means we put more quality or sustainability into the product.

I think we are in a sweet spot, being an accessible luxury brand. If the world is going well, people are willing to buy more expensive pieces, but when it gets a bit more tough, they still want to have a good brand, a good product with a good price value.

This interview has been edited and condensed.

FASHION SYSTEM

06. DTC RECKONING

07. TACKLING GREENWASHING

08. FUTURE-PROOFING MANUFACTURING

09. DIGITAL MARKETING RELOADED

10. ORGANISATION OVERHAUL



06. DTC RECKONING

Though brands across price segments and categories have embraced digital direct-to-consumer channels, mounting digital marketing costs and e-commerce readjustments have put the viability of the DTC model into question. To grow, brands will likely need to diversify their channel mix, including wholesale and third-party marketplaces, alongside DTC.

KEY INSIGHTS

1. Unprecedented e-commerce growth rates are normalising. E-commerce sales are expected to grow at a CAGR of 10 percent in the US and 11 percent in Europe between 2022 and 2025, far slower than the 30 percent growth seen from 2019 to 2020, and more in line with the pre-pandemic rates of 15 percent and 14 percent from 2016 to 2019.
2. Profitability in the online DTC channel is suffering, as digital marketing costs grow alongside online return rates — costing brands between \$21 and \$46 per returned product on average.
3. Brands are doubling down on physical touchpoints, from monobrand stores to concessions at multi-brand retailers. In 2022, physical store openings in the US outpaced closures for the first time in over three years.

EXECUTIVE PRIORITIES

- | | |
|---|--|
| Make it multichannel | For most brands, DTC channels should be reserved for the most loyal, high-value customers and combined with other multi-brand retail and marketplace channels to drive growth. |
| Rethink the physical footprint | Map out which physical stores continue to deliver ROI, leveraging physical touchpoints as opportunities to bring the brand to life for customers and build an emotional connection. |
| Leverage retail partnerships for discovery | Reach new customers and experiment with a physical retail strategy without intensive investment in monobrand stores through selective collaborations with retail partners and activities like pop-ups. |

FASHION SYSTEM

E-commerce grew at an unprecedented rate during the pandemic, but the days of heady growth now appear short-lived. After online purchases surged 30 percent year on year in 2020 in the US and Europe, a new reality is settling in. Between 2022 and 2025, e-commerce is expected to grow at a compound annual rate of 10 percent in the US and 11 percent in Europe²³¹ — much closer to pre-pandemic levels seen between 2016 and 2019, where e-commerce grew 14 percent in the US and 15 percent in Europe. In China, online retail sales have grown less than 10 percent since the end of 2021, after having risen more than 16 percent year on year in 2019.²³²

Regardless of the extent to which fashion brands have built their businesses around selling direct to consumers online, the deceleration of e-commerce growth requires a careful recalibration of channel strategies. Pure-play DTC brands themselves may offer lessons for others about how to manage the change ahead.

DTC Darlings

When a new generation of DTC labels arrived online over the last decade, the fashion industry was ripe for innovation. These DTC start-ups, backed by millions of dollars of venture capital, captivated consumers with an alluring premise. By avoiding third-party retailers, they posited that they could break free of traditional merchandising constraints to offer more innovative products, wider assortments and higher levels of customer service than other brands. To get the word out about their products and services, they benefited from earlier waves of low-cost, highly accurate targeting in digital marketing.²³³

“DTC” soon became the buzzy acronym in the industry, as digital-first brands across categories scaled fast. Canadian jeweller Mejuri, Brazilian brand Farm Rio, French contemporary label Sézane and Chinese beauty brand Perfect Diary are among the companies that soared in

popularity with consumers.^{234 235}

The DTC model was further validated when the pandemic hit and most physical retailers were forced to shut, either temporarily or permanently.²³⁶ Department stores that were already under financial pressure, like Debenhams in the UK, filed for bankruptcy.²³⁷

Meanwhile, established global brands, such as Prada and a number of sportswear players,²³⁸ had been shifting their focus towards DTC channels, in a strategic move to gain first-party customer data amid increased e-commerce adoption and ongoing challenges to wholesale channels.

But in 2022, cracks appeared in the digital pure-play model. As DTC brands began going public, their stock prices began to suffer.²³⁹ The share prices of 10 apparel DTC brands fell by around 70 percent in the first three quarters of 2022, compared with the MSCI World Consumer Discretionary Goods Index's decline of 32 percent over the same period.²⁴⁰

For many digitally focused brands, profitability has proved elusive. A structural challenge that many of these brands face is their narrow assortments: Brands like Warby Parker and Allbirds have been looking for ways to expand their offerings in a bid to generate repeat purchases for limited assortments.²⁴¹

Another major, and growing, challenge is the rising costs of digital marketing as social media platforms become more crowded and competitive and new privacy regulations restrict customer targeting across digital channels. (See Digital Marketing Reloaded on page 98.)

E-commerce brands are also contending with high, margin-eroding return rates. Retailers are paying between \$21 and \$46 per returned product on average when taking shipping, processing and other costs into account.²⁴² In the US, return rates across all sales channels increased to 16.6 percent in 2021 from 10.6 percent the year before, with the average return rate for online orders even higher at 20.8 percent.²⁴³ US



A Glossier store at pop-up village The Current. Glossier.

multi-brand online retailer Revolve reported a 54 percent return rate in the first quarter of 2022, while Boohoo's UK return rate hit 33.7 percent in April, up nearly 10 percentage points from the prior year.²⁴⁴

The Evolving Role of Physical Retail

Though brick-and-mortar chains were pushed to reduce their footprints or shutter completely as much of the fashion's industry investment went online in recent years, the contraction in physical retail looks to be stabilising.²⁴⁵ In 2022, US store openings outpaced closures for the first time in at least three years.²⁴⁶ Though retail foot traffic remains between 10 percent to 20 percent lower than in 2019,²⁴⁷ the productivity of stores has risen: in the US, sales per square foot increased 13 percent year on year in 2021.²⁴⁸

A range of digital-first brands have invested in opening their own physical stores, finding it difficult to generate a profit through

online DTC channels alone.²⁴⁹ Everlane opened its first permanent physical store in 2017²⁵⁰ and now operates 10 stores across the US,²⁵¹ despite its founder famously claiming in 2012 he would "shut the company down" before opening a physical store.²⁵² Allbirds operates 54 stores globally as of September 2022,²⁵³ while Warby Parker has announced plans to expand its footprint to 900 stores.²⁵⁴

Brands exploring brick-and-mortar may find that rents are more favourable in many key urban markets than they were before the pandemic. Leases in shopping centres and high streets in the UK have declined between 20 percent and 30 percent compared to 2019 levels.²⁵⁵ In the US, store vacancy rates in 2022 exceeded 2019 levels.²⁵⁶ Landlords have become more favourable retail partners by offering special terms such as rent escalation,²⁵⁷ in which the brand pays a low rate at the start of its lease followed by increases over time in accordance with performance, thereby sharing the risk of opening a new store with the landlord.

Menswear brand Drake's has benefitted from such terms at its New York location, so that if the brand performs well, it pays more to the landlord in rent.²⁵⁸

At the same time, the role of brick-and-mortar is evolving. To generate higher revenue, stores should be digitally enabled and fit seamlessly into the overall physical-digital multichannel strategy. Strategies like integrating mobile apps to optimise in-store experiences for customers can drive greater sales in each store, while Radio-Frequency Identification (RFID) product tags allow brands to track and maintain appropriate inventory levels.²⁵⁹ With one store already in Los Angeles, Amazon Fashion opened its second physical store

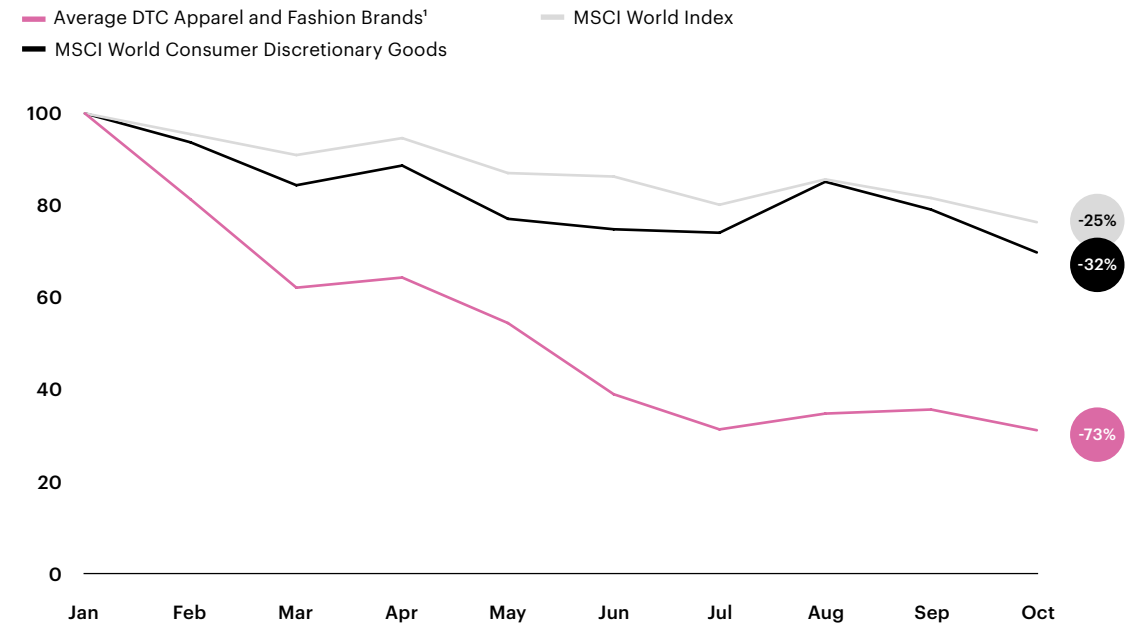
in Columbus, Ohio, in October 2022 with a range of technologies, including enabling customers to scan QR codes with the company's shopping app and add products to a fitting room.²⁶⁰

Stores also provide marketing value, enabling brands to bring their aesthetics to life, like Balenciaga's fake fur-lined pop-up for the launch of its Le Cagole bag in central London, or Uniqlo's flagship store — also in the UK capital — that showcases the restored art-deco design of a 1920s barber shop that previously occupied the space.²⁶¹ Others offer spaces exclusively to top-tier customers, such as Chanel's plan to open boutiques that will only be available to top-spending clients,

Exhibit 12:

DTC fashion stocks have underperformed others in 2022

DTC apparel stocks and MSCI global consumer indexes, 2022 (Index=100)
% change



¹ Selection of publicly listed DTC apparel and fashion brands
Source: Yahoo Finance and CNBC

FASHION SYSTEM

starting in key cities in Asia.²⁶²

“The retail store is the last point where you actually can solidify the connection that you have already built through wholesale and through DTC [online],” said Andrea Baldo, chief executive of Ganni, which has expanded from digital channels and wholesale partnerships to mono-brand stores.²⁶³

The Benefits of Partners

Much in the same way that brands (and their landlords) are rethinking physical stores, department stores are shifting their approach to partnerships with the brands. This can create opportunities for brands even if department stores are continuing to face their own challenges around inventory and foot traffic, and have historically required that the brands they carry agree to less advantageous terms around delivery schedules and discounting.

“Before, the retailers were dictating terms; now, it’s a collaboration, a partnership between brands and retailers,” said Domi Szabó, group wholesale director at European fashion holding company Vanguard. ²⁶⁴

Carefully selected partnerships with high-quality wholesalers and multi-brand retailers can generate value for brands. DTC unicorn Glossier, for example, announced its first wholesale deal for its makeup and skin care with Sephora in 2022, significantly expanding the brand’s distribution.²⁶⁵ In 2022, analysts credited sportswear brand Puma’s 20 percent sales increase in the first quarter of 2022 to a newly expanded wholesale strategy.²⁶⁶

Increasingly, department stores and boutiques are willing partners on special retail installations, which can benefit both retailer and brand. Such tie-ups can help multi-brand stores attract new customers and allow brands to understand where and how to open their own physical stores. French designer label Jacquemus, for example, opened high-concept, surrealist

pop-ups at UK department store Selfridges in spring 2022 before experimenting with its own temporary sites in other cities in the months that followed.²⁶⁷

Multichannel Playbook

Even as e-commerce is losing its pandemic-era allure, brands are exploring ways to reach new customers online outside of social media and their own websites. In China, where platforms like Tmall, Taobao and JD.com are well established, third-party marketplaces account for as much as 80 percent of luxury e-commerce spending.²⁶⁸ Beyond China, many brands are considering new or expanded partnerships with marketplaces like Zalando and Farfetch, which offer access to large customer groups and can allow brands to control their own shipping and logistics. In the US, brick-and-mortar retailers such as Macy’s and Walmart have launched their own marketplaces to compete online.

At this juncture, only a handful of companies with the highest levels of brand loyalty — such as Chanel or Nike — or sheer scale — like Zara, H&M and Uniqlo — have shown that they can drive growth through a DTC-first model.

With this, the playbook for physical stores and wholesale has evolved. Today’s customers expect brands and retailers to interweave digital conveniences with physical services, like the ability to pick up or return online orders in stores.²⁶⁹ As such, a physical presence is increasingly critical for scaling, and innovative store formats are essential.

To be sure, direct digital channels will remain a fundamental part of a multichannel mix in the years to come — especially for brands’ repeat customers. But direct sales can be complemented by a diverse channel strategy that attracts new customers and provides a strong foundation for growth.



An Allbirds store. Shutterstock

Allbirds: Conquering the New Multi-Channel Landscape



Tim Brown
Co-Founder and Co-Chief Executive,
Allbirds

Today, running an online business requires more than just a Shopify storefront and ads on social media. Allbirds co-founder and co-CEO Tim Brown unpacks the new rules of the direct-to-consumer playbook, which has evolved alongside a maturing e-commerce market.

— by Cathaleen Chen

When online shopping erupted at the height of the Covid-19 pandemic, many predicted it would be the last straw for physical retail. For some struggling businesses, it undeniably was. But to the industry's surprise, stores have returned with a vengeance. At the forefront of today's brick-and-mortar boom are digitally native newcomers that see stores as marketing opportunities rather than just a means of generating sales.

Among them, footwear brand Allbirds now has over 50 locations, and that's not counting its growing presence in department stores too. Together, retail and wholesale represents new opportunities

FASHION SYSTEM

for young companies to reach new customers — especially as online advertising has grown exorbitantly expensive in recent years. Embracing these channels will be critical to navigating the new era of retail.

Allbirds co-founder and co-CEO Tim Brown identifies what's driving the DTC evolution and dissects the exponential value of stores and wholesale partners.

Some say the direct-to-consumer model has become outdated. How have you observed the channel's evolution from its heyday in the 2010s?

Terms and labels go in and out of fashion, and the DTC one certainly feels like it's become a negative interpretation of a business model that was heavily reliant on cheap, Facebook, social media-based advertising. Then, when that changed, when that became more expensive, the business model no longer worked. But when I think about direct-to-consumer, what I think of is really the growth of people's comfortability with buying things online and the rise of new brands, infused with purpose.

So, at its best, I think there are some principles that are not going anywhere. In our particular case, the unfair advantage we had as a business was control of the digital ecosystem, incredible amounts of data and a direct relationship with our customer that allowed us to iterate and prove our products really, really quickly. I think at its root at least for Allbirds, that model for us was about innovation and consumer centricity.

From that original DTC

playbook, what elements have gone out of style and what remains?

What has gone away is the idea that it's as simple as cutting out the middleman, the wholesaler, creating a brand without too much thought, and plugging it online, and then taking advantage of really cheap customer acquisition. I think that story has not played out really well, and I think it's become incredibly crowded. Some brands capitalised on a moment in time when there was a certain economic situation that made the ability to build brands quite quickly online. Others are inherently anchored to long-term visions and purpose, and they're broader than the channel strategy, and I'd like to think that's absolutely us.

The social commerce landscape looks quite different today than it did five years ago. How has the role of social media ads evolved for Allbirds, and would you say it's in line with the approach of other e-commerce brands?

I can't speak to my peers. I would sort of say it's always been a really relatively small part of our business, and our approach. Like everyone else has seen, it's gotten more expensive, but we have our retail stores, a powerful word-of-mouth awareness that has driven our brand from the beginning and a really loyal community of customers. Ads are a small part of the story and not something that we spend a lot of time worrying about. We adapt and adjust like everyone else to rising costs, and in every aspect of the business, there are ups and downs at any given time.

As performance marketing

costs have skyrocketed, what are new avenues of marketing that Allbirds is exploring?

One of the big things that's really been attached to our retail store growth is the idea of our community. We call it Allgood Collective. It's a series of localised ambassadors, many of whom are connected to our retail stores, that we use in a range of different ways to test products. They tend to be very powerful, local voices, on a range of topics, and this community manifests itself in the form of running clubs in some cases. It's a cohort of 200 people, and it's something that we're really, really excited about.

Allbirds has opened dozens of stores in recent years. What role does physical retail serve for digitally native brands?

Let's start with the consumer experience. Everyone's got a childhood memory of going to a shoe store, getting fitted with a metal sizing device that no one can remember the name of, and a store clerk disappearing to a ... basement only to return without your size. So the biggest opportunity we saw really was to remake that experience, and create a seamless interplay between online and offline.

Then I think, in our particular case, we've worked on natural materials innovation and sustainability, and the ability to feel and touch our products is an inherent advantage, and it's best done in person.

What we see is when we put a store in — we've got 54 of them now — we see an uptick in digital traffic around those stores, and we're able to use it as a customer acquisition vehicle for the best customers that we have within

EXECUTIVE INTERVIEW

our ecosystem. Then on top of that, and this is the best bit about it, the level of knowledge among those frontline retail store staff of what's working, and what isn't, is phenomenal. We still have our very first store, it was right under our office, 30 yards away from where I'm sitting [at the company's headquarters in San Francisco], and I'm in there just about every day, because if we launch something, I want to know what's going on. That's where we find out very quickly.

Allbirds entered into a wholesale agreement with Nordstrom in May. Wholesale is another channel that's been traditionally neglected by DTC players. What is the value of these partnerships for a brand like Allbirds, and what are the potential challenges or risks?

Wholesale has never been something that we were never going to do. It was always a matter of timing for us. Previously we've worked with Nordstrom before with shop-in-shops, and they've been wildly successful.

For us it's always about, where is our consumer, how do we best meet them, and how do we optimise for the brand experience. That really is the thing that we focus on the most. Nordstrom, we've been talking with for a long time, and it made sense, six-and-a-half years in, to open up a more formal channel. Similarly with Selfridges in the UK. What a great partner for us to both meet new people and establish ourselves in a new market.

Similarly, we work with [US outdoor apparel and equipment retailer] REI, and one or two others. It's been really selective.

In many cases, we've been chatting with these folks for multiple years. It's the right time, and it allows us to meet customers that don't know us. We're still very, very early, and have, relatively speaking, low brand awareness for the size of the market. In some cases, with wholesale, we're able to meet folks where we don't have stores, we don't have a physical presence, and probably don't plan to in the foreseeable future.

In times of economic uncertainty, investors want to see even healthier bottom lines. [Allbirds reported net revenue of \$140.9 million for the first six months of 2022, up from \$117.5 million year on year, and adjusted EBITDA loss of \$21.4 million, compared to a loss of \$5.8 million.] What is Allbirds' path for profitability?

We have a really clear path to profitability. There have been obviously some short-term challenges the last few years with Covid. We're a young business too. We're also balancing the need to invest in the infrastructure to be an iconic, global brand, and take advantage of the opportunity that we believe exists in a large way and capitalise on this emerging consumer shift away from synthetic plastic products towards natural, sustainable ones. Like anything else, we're balancing that investment, and we face some short-term pressures around that. The path to profitability is clear for us and it's just going to take a little bit longer than we planned, but we've got a very clear line of sight on that.

E-commerce growth in

general slowed in 2021. How do you define the post-pandemic consumer? Has there been new buying patterns that emerged?

I think we're still working that out. Part of our consumer base is buying our product because it's extremely comfortable, versatile, and they're wearing it into the office, and they're dressing it up, and they're dressing it down. One of the big things that we're seeing is people are out and about, they're travelling more, they're back out in the world, and I think that's really benefited us. So we see a lot of positive tailwinds albeit in a tenuous economic environment that we currently sit in.

This interview has been edited and condensed.

07. TACKLING GREENWASHING

As the industry continues to grapple with its damaging environmental and social impact, consumers, regulators and other stakeholders may increasingly scrutinise how brands communicate about their sustainability credentials. If brands are to avoid "greenwashing," they must show that they are making meaningful and credible change while abiding by emerging regulatory requirements.

KEY INSIGHTS

1. Policymakers are highlighting thorny questions looming over the industry: what is sustainable fashion and which brands — if any — can claim to sell it?
2. A quarter of consumers in the UK said their purchase decisions were driven by sustainability, reflecting a broader pattern across geographies, and elevating the importance of sustainability marketing for brands.
3. Caution is needed to avoid misleading or confusing consumers if communication is not clear, consistent and accurate. Missteps for brands can lead to not only reputational damage but also regulatory or legal action and fines.

EXECUTIVE PRIORITIES

- | | |
|---------------------------|--|
| Lay the groundwork | Invest in research and data intelligence to gather robust, verified evidence to substantiate and credibly support sustainability claims — and share findings with stakeholders transparently. |
| Connect functions | Build bridges between the company's sustainability, marketing and legal teams so that that external, and internal, well-informed sustainability communications capture the complexities of responsible business practices. |
| Be precise | Avoid broad, vague terms like "green" or "eco-friendly," which can have multiple interpretations and give a false impression about impact. Instead, provide important caveats or context, along with concrete and factual information. |

The European Commission is homing in on the word “green.” When its policymakers in the spring of 2022 laid out a plan to make textiles more durable and recyclable by 2030, they addressed not only waste reduction and circularity, but also how the fashion industry communicates with its customers. The strategic roadmap aims to crack down on “greenwashing,” stating that terms like “eco-friendly” and “good for the environment” will be “allowed only if underpinned by recognised excellence in environmental performance.”²⁷⁰

While the EU plan is not enforceable legislation, its policymakers — like those in other parts of the world — highlight thorny questions looming over the fashion industry in 2023: what is sustainable fashion and which brands — if any — can claim to sell it? While brands have grappled with their own answers for years, governments and regulatory bodies are signalling that existing definitions may be insufficient and, in many cases, misleading.

Consumer watchdogs in Norway and The Netherlands have ruled a number of high-profile marketing campaigns by big brands were misleading. In the UK, the Competition and Markets Authority launched a review of sustainability claims in the fashion retail sector in 2022, taking aim at fashion as one of the worst-offending industries when it comes to greenwashing. The review scrutinised fast-fashion brands that it believed may be using misleading language or cherry-picking information they share with consumers in a bid to appear more sustainable than they actually might be.²⁷¹ As a result, some companies are overhauling how they present sustainability claims.²⁷² Meanwhile in France, legislation expected in 2023 will require brands to add “carbon labels” to clothing and textiles, which will display an environmental “score” from A to E to help consumers make more informed purchase decisions.²⁷³

This increased scrutiny and regulation come as a growing number of consumers place

importance on the environmental or social impact of the fashion they buy.^{274 275 276 277} A quarter of respondents to a 2021 survey by McKinsey in the UK said their purchase decisions were driven by sustainability,²⁷⁸ while 80 percent of consumers in a US survey said sustainability was an important factor when selecting a fashion brand to shop from.²⁷⁹ In another 2021 survey in India, 94 percent of consumers said they were willing to pay high prices for “ethical” products.²⁸⁰ Younger consumers are especially motivated by sustainability concerns: half of Gen-Z shoppers in China said they aimed to buy less fast fashion in a recent survey about sustainable consumption.²⁸¹

Fashion companies have been responding to this growing interest in sustainability. Many have stepped up public disclosures of sustainability-focused initiatives in recent years, though evidence of progress from such initiatives is limited, the BoF Sustainability Index’s 2022 edition found.²⁸²

In parallel, brands should be aware that even sustainability-focused consumers are struggling to make sense of the information they encounter while shopping.²⁸³ In a University of Melbourne survey of Australian consumers in 2019, most respondents were “overwhelmed” when trying to understand how garments are made and “deeply skeptical” of brands’ own claims.²⁸⁴ Similarly, American respondents in a 2021 survey conducted by biotech firm Genomatica echoed these views: 42 percent of the teenagers and adults polled said they were unsure what makes clothing sustainable, while 88 percent said they did not trust brands’ claims.^{285 286}

What’s In a Definition?

The complexity of sustainable business practices requires a holistic approach to tackle an array of environmental and social factors, from carbon emissions to garment workers’ rights. Within this, the industry does not always align on a shared vision for change, which can add to confusion

among consumers. For example, while the leather supply chain is often associated with animal cruelty and “unsustainable” farming, many “sustainable” vegan alternatives are criticised for containing harmful amounts of plastic.²⁸⁷

Any brand wanting to operate more responsibly faces tension when attempting to deliver on the promise of sustainability, leading some to even avoid using the term “sustainable” altogether. US outdoor clothing retailer Patagonia — despite its efforts to pioneer responsible business practices²⁸⁸ — does not refer to its business or products as “sustainable” as part of its company policy, explaining that “we recognise we are part of the problem.”²⁸⁹ Similarly, Ganni took to Instagram in 2021 to explain “why we’re not a sustainable brand,” instead highlighting its focus on being transparent and honest.²⁹⁰ The Danish fashion label, which worked with the United Nations Development Programme to create a zero-impact collection, clarified that criticisms about its progress “would most likely be justified.”

Any brand wanting to operate more responsibly faces tension when attempting to deliver on the promise of sustainability.

“With no standardised language or regulated frameworks, deciphering what companies are actually doing is extremely challenging,” said Kenneth P. Pucker, former chief operating officer of US outdoor footwear brand Timberland and now an advisory partner at Berkshire Partners, in 2022.²⁹¹

While third-party certification systems and impact assessment tools have emerged to guide brands and consumers, these have also stirred debate. In 2022, one of fashion’s most adopted rating systems, the Higg Index, faced a range of criticism, from the quality and accuracy of the data it provides to the potential for big brands to

influence it. After ruling that the index’s consumer-facing effort can be misleading, Norway’s consumer authority banned reference to the Higg Index in marketing materials in June 2022.^{292 293} The Sustainable Apparel Coalition, the group behind the index, put the programme on pause and commissioned an independent review of its data and methodology.²⁹⁴

Aligning Behind a Common Cause

The need for common frameworks is clear. In 2021 at the request of G20 leaders, the International Financial Reporting Standards body launched the International Financial Reporting Standards Board to provide a disclosure baseline to help capital markets participants track climate impact. “Rarely do governments, policymakers and the private sector align behind a common cause,” said Emmanuel Faber, chair of the ISSB. “However, all agree on the importance of high-quality, globally comparable sustainability information for the capital markets.”²⁹⁵

The ISSB issued its first draft for the baseline in early 2022. The reporting system, if adopted widely, could allow investors as well as consumers to compare brands across industries. However, it might not be specific enough to highlight the fashion industry’s particular challenges.^{296 297}

At the same time, cross-player initiatives that seek to provide a framework for brands to assess and communicate their impact continue to emerge ahead of incoming regulation. In February 2022, 50 beauty companies, including The Estée Lauder Companies as well as professional associations, formed a consortium in partnership with independent bodies to develop an “eco beauty score” for cosmetics companies to assess their environmental impact.²⁹⁸ There is, however, a great deal of criticism facing industry-backed initiatives in general. As such, brands should ensure they work with independent third parties and conform to

ongoing regulatory efforts to reduce concerns about their efficacy.

Before brands can accurately talk about their credentials, they should dig deep into their own operations and supply chains to gather data that they can benchmark effectively.²⁹⁹ For example, Swedish fashion brand Asket has invested in tracing its full supply chain and gathering data to communicate the origin, impact and cost of each garment to consumers.³⁰⁰ As regulators increase the requirements to back up any sustainability claims, investment in tools to gather and manage supply chain data is likely to become more widespread.

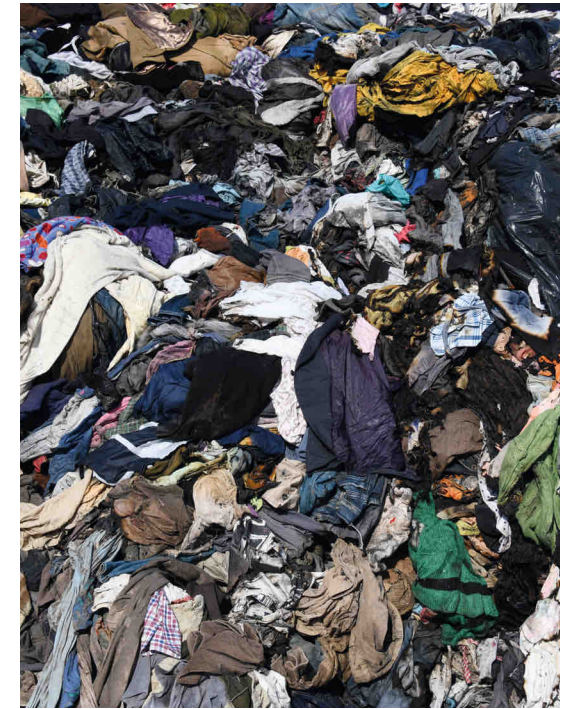
Stronger bridges should be built between companies' technical sustainability and marketing teams to review how information can be communicated in a responsible and effective manner, ensuring that marketing messages are not created in isolation. With incoming regulation, vague marketing around sustainability is no longer just a reputational risk — it could lead to fines or even legal action.

Language that could mislead consumers — such as broad terms like “green” or “eco-friendly” — should be avoided as it could give the impression that products have positive environmental

attributes. Instead, important caveats or context should be made accessible to consumers, such as specific supply chain data brands can gather to show a reduction in impact against a defined baseline. For example, France-based luxury company Kering has produced internal guidelines on sustainability communications for its staff to help avoid greenwashing-related legal issues and a consumer backlash; the guidelines advise the brands under its ownership to avoid broad, generic terms like “environmentally friendly” and instead focus on clear, unambiguous statements on metrics such as emissions reduction.³⁰¹

To be sure, brands will still be able to identify and talk about the sustainability issues that matter most to their consumer base amid increased scrutiny, but in doing so they must ensure their claims are backed up by robust work. When ultra-fast-fashion giant Shein launched a resale platform for American consumers in October 2022 as part of a series of efforts to combat criticism,³⁰² it was called out for greenwashing; research has found that resale platforms to date typically do not help to decrease production levels, particularly for fast-fashion brands.³⁰³ While staying abreast of upcoming regulation, fashion leaders should seek customer feedback by, for example, monitoring net promoter scores to understand their business's perceived sustainability progress, areas of improvement, and preferences for how and when communication is delivered. Technology and digital tools will play a critical role to ensure better traceability along the value chain, from data platforms to facilitate information gathering across all production stages to rigorous data standards to track sustainability metrics.

In 2023, new communication strategies about sustainability will be required. To move the needle, brands will also need to become more forthright about their progress and shortcomings, whether it be through public reporting or product labels. If brands do not find a responsible and effective way to talk about their sustainability



Garments disposed of at end of life. Shutterstock.

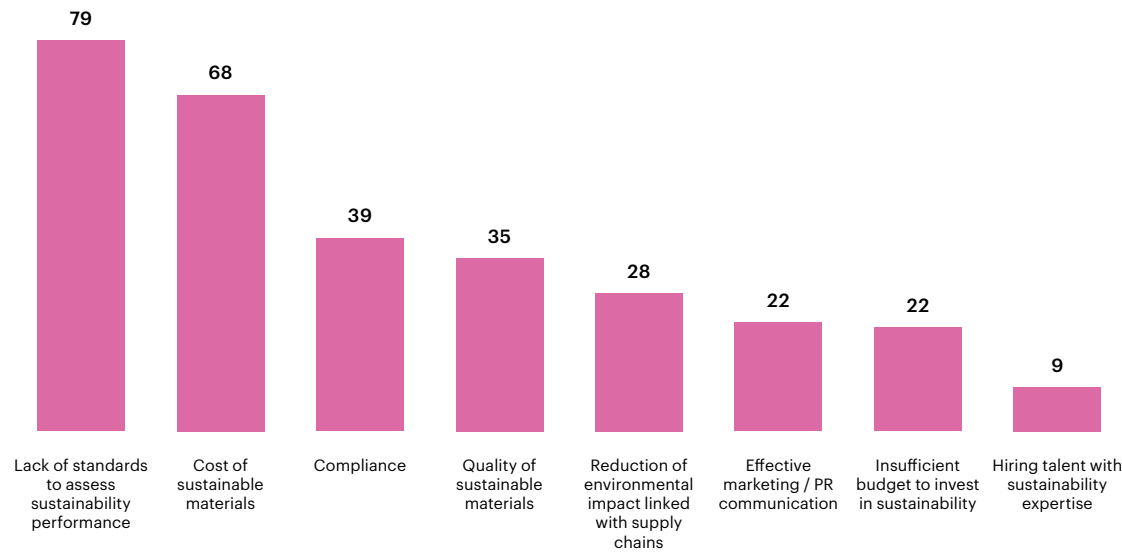
journey, they may risk damaging consumers' trust or may face compliance repercussions, thus requiring brands' legal teams to work closely with communication colleagues.

Fashion leaders have an opportunity in 2023 to forge new rules of engagement when it comes to sustainability, from aligning company-wide marketing as well as regulatory and other disclosures to working with policymakers, industry bodies and other brands to address pain points. Communication should reflect a brand's long-term commitment to sustainability, articulating realistic, timebound targets and progress being made towards them. Yet ultimately, brands that are best equipped to make meaningful and credible change will be those that ensure every part of their operations is doubling down on sustainability, not just talking about it.

Exhibit 13:

Fashion executives believe a lack of standardised tools and metrics is the greatest hurdle to improving how consumers perceive their sustainability efforts

Biggest challenges to improving sustainability credentials in the eyes of consumers, % of respondents



Source: BoF-McKinsey State of Fashion 2023 Survey

A New Approach to Scaling Innovative Materials

The materials upon which the fashion industry is dependent are part and parcel of the industry’s move to improve its environmental impact and meet the sustainability expectations of customers and regulators alike. In the year ahead, fashion leaders should see this as an opportunity to tap into the expanding ecosystem of new, sustainability-focused materials, while addressing a key challenge: how to help this ecosystem scale.

by Nic Cornbleet, Steve Hoffman, Jonatan Janmark and Karl-Hendrik Magnus

Fashion is among the most unsustainable industries on the planet, responsible for around 3 percent to 5 percent of global carbon emissions.³⁰⁴ Oil-based polyester accounts for about 50 percent of fibre production, and cotton, which is reliant on large volumes of water, land, fertiliser and pesticides, contributes another 25 percent.³⁰⁵ Moreover, the industry remains steadfastly linear — billions of pieces of clothing are simply discarded when unsold or at the end of their useful lives, ending up in landfill or incinerators.

Despite some progress, the industry is struggling to adopt sustainable innovations at scale, due to multiple factors including limited processes for collection, sorting and pre-processing; costs; and output quality.³⁰⁶ The collection rate of discarded textiles from households is, for instance, only 30 percent to 35 percent on average.³⁰⁷ However, material production contributes between 25 percent and 40 percent of the industry’s CO₂ emissions.³⁰⁸ This arguably presents a powerful incentive to redouble efforts to scale the production of more sustainable alternatives. Materials are the tangible essence of fashion — physical fibres that consumers can see and feel. Brands can use this immediacy

to create differentiated offerings and help enable consumers to make more sustainable choices.

The industry may be approaching a tipping point. Consumers increasingly demand sustainable choices, and younger cohorts in particular are willing to pay more for items that reflect their sustainability values.³⁰⁹ In addition, significant R&D investment mean several technologies and new materials are likely on the verge of application at scale.³¹⁰

There are many facets to the fashion industry’s sustainability journey, from reducing consumption to extending product lifespans through design. Materials recycling and innovative fibres warrant more fashion industry attention. Progress in these two areas could enable the fashion industry to significantly improve its sustainability, thanks to the emergence of cost-competitive solutions and the potential to tangibly connect with customers.

The Long Road to Scalable Impact

The fashion industry is accelerating investment in material alternatives that are more sustainable than traditional ones, both through textile innovation and recycling. Many innovations are being tested in

Exhibit 14:

Material production creates the greatest climate impact across the fashion lifecycle

Relative climate impact across the major steps of the fashion lifecycle



¹ Final output of the material production process is textile fibre

² Impact of microplastics is not considered in this impact sizing

³ This does not include energy use in the recycling process

Source: McKinsey and Global Fashion Agenda, Fashion on Climate

the market, including bio-based and compostable materials such as hemp, leather alternative Piñatex and vegan Mylo leather. New waste-based materials include Spinnova, which is made from cellulosic fibre, and Agralooop, which converts agricultural crops into textile-grade products. Meanwhile, companies such as Newlight Technologies and Fairbrics are spearheading the production of regenerative materials from greenhouse gases.

Besides certified cotton and man-made cellulosic fibres, the only material alternative that has achieved meaningful scale is recycled polyester from PET bottles.³¹¹ But rPET carries certain scaling challenges for the fashion industry, not least because it is also in high demand in other industries, many of which — including consumer goods — are able to use feedstock in closed-loop systems more sustainably. Once used in textiles, such polyester will probably not be recycled again. This is a key area of waste that the industry could likely start to tackle by recycling it into new materials.

Beyond Recycled Polyester

The only other scaled material alternative is

cellulose-based Lyocell, a form of rayon invented in the 1980s that accounts for less than 2 percent of global textile volume.³¹² This is not a rate of adoption that will make a significant difference to meeting industry-wide or company sustainability targets. A likely solution for improving adoption could be found in two areas: textile-to-textile recycling and new materials that are more sustainable than virgin ones.

Textile-to-textile recycling recovers materials from pre- and post-consumer textile waste to produce yarns for new fabrics.³¹³ This sort of closed-loop recycling could be applied to between 18 percent and 26 percent of gross textile waste in Europe by 2030.³¹⁴ Renewcell, Ambercycle, Circ, Gr3n and Worn Again Technologies are among the relatively high-profile companies specialising in textile-to-textile recycling.

The technology has piqued investor interest, fuelling expectations that its ability to scale is imminent. For example, in 2022 mechanical cotton recycler Recover raised \$100 million, led by Goldman Sachs Asset Management, to fund the next stage of its expansion. Worn Again raised £27.6 million (\$31.7 million) from strategic investors such as H&M in October 2022 to help

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fund a new textile-recycling demonstration plant in Switzerland, bringing the start-up's total fundraising to £42.9 million.³¹⁵

With hundreds of materials patents being issued every year, the industry is seeing increasing momentum, albeit at a small scale. Companies involved in this space include Bolt Threads, which manufactures bio-based Mylo, and Natural Fiber Welding, which produces USDA-certified 100 percent bio-based and fully recyclable Mirum.³¹⁶ Cellular agriculture specialist Galy has created a form of in-vitro cotton which it says uses 78 percent less water and 81 percent less land than traditional cotton.³¹⁷

Both textile-to-textile recycling and scaled innovative materials could be prioritised in parallel since they are mutually reinforcing: while recycling and feedstock collection rates grow, innovative materials can alleviate volume pressure on virgin materials such as natural cotton. In doing so, innovative materials also could enable a greater number of producers of these virgin materials to switch to more sustainable practices, such as organic, regenerative farming or certified sustainable forestry.

Demand for scaling is being driven by several factors, including increasing regulatory attention and growing consumer expectations that the fashion industry will soon find solutions to its sustainability problems.³¹⁸

In the past, consumers said that while they supported sustainability in fashion, they were not willing to pay more for sustainable products. But a recent survey of Americans aged between 18 and 24 said they are willing to pay a premium of nearly 15 percent for clothes made with recycled materials.³¹⁹ Meanwhile, 54 percent of consumers anticipate buying more recycled clothes and 92 percent would take part in a brand-sponsored recycling programme.

Meanwhile, about half of European purchasing officers expect more than 30 percent of their products to contain recycled fibres by 2025.³²⁰

Various guidelines and advisories are being rolled out. The EU Strategy for Sustainable and Circular Textiles decrees that textile products should be long-lived and recyclable by 2030. Brands and material producers are responsible for

making that happen, according to the regulators. Meanwhile, the EU's Article 11(1) in the Waste Framework Directive outlines that member states are required to have separate textile-waste collections by 2025, though expanding collection rates significantly will be challenging.

From a commercial perspective, recycled fibres such as polyester, polyamide or man-made cellulosic fibre can in many instances be produced at price parity or at a lower cost than virgin fibres when the full value chain is scaled.³²¹ And in any event, the input material costs need not be a significant hurdle to progress. In a scenario where a 25 percent "green premium" is added to the cost of fibre, the increase in the retail price would only be about 3 percent, our analysis shows. And scale begets efficiency — creating a virtuous circle of innovation, investment and further scaling.

Potential Next Steps for Material Innovators

Other industries can offer fashion companies lessons on how to overcome barriers to scaling and adoption. "Green tech" ventures in steel and energy, for example, show that excellent execution can be a catalyst to significant scaling that leapfrogs the usual transition process. Forward-looking companies often concentrate their efforts on six areas:

Game-changing ambition: Sustainability leaders super-size their scaling targets. Think in terms of 150 times current volumes, or reaching 5 million to 10 million tonnes of sustainable fibre production by 2035. One reference case is battery developer Northvolt, which aims to move from 16 gigawatt-hours (GWh) to 180 GWh by 2026 and to 250 GWh by 2030, having raised \$8 billion in equity and debt since 2017 to fund this ambition.³²²

Model cost and capex: Materials innovators can calculate the scaling break point for costs compared to incumbents and focus on achieving this. To support this, fashion companies may be willing to offer short-term price premiums. One example of the dynamic appears in the hydrogen industry. Green-hydrogen costs are projected to fall by 60 percent by 2030, and the break point between grey and green hydrogen will be about 65 GW of scaled electrolyser capacity.

IN-DEPTH

Exhibit 15:

If a brand were to pass on a green fibre premium of 25% to customers, it would lead to a 0.5% to 3% increase in retail prices

Example analysis of implications of green fibre premium prices on the final retail price

Garment type	T-shirt	T-shirt	Sweatshirt	Jacket	Dress
Retail price	€19	€23	€103	€56	€19
Fibre composition	100% Organic Cotton	50% Organic Cotton, 50% Modal	50% Lyocell, 50% Organic Cotton	71% Polyester, 29% Lyocell	100% Polyester
Weight	200g	200g	350g	275g	300g
Increase in retail price with 25% fibre premium	-3%	-1%	-0.5%	-0.5%	-1.5%

Source: McKinsey & Company

Captive demand before scaling: Offtake agreements as well as direct investment by customers can reduce commercial risks. As an example of a surety that can support innovation, fashion company Inditex entered into a deal to buy recycled fibre from Infinited Fiber Company in the next three years.³²³

Parallel scaling for speed: Leading companies develop a replicable standard for production based on the first business deployment. This can initiate new growth waves before the first is completed.

New business ecosystems: Innovation leaders can create business ecosystems to help scale recycled materials. This may require new textile collection and sorting infrastructure to deliver sufficient feedstock. A precondition is value chain collaboration and partnerships with equipment providers to grow capacity. US fabrics manufacturer Milliken & Company said it will participate in textile-to-textile recycling trials and develop a rapid prototyping centre as part of its commitment to the Accelerating Circularity initiative.

Sustainable operations: Successful green businesses set ambitious targets, innovating and forming partnerships across their end-to-end operations. Austrian fibre producer Lenzing in

2022 completed work on a Lyocell plant in Thailand that is entirely powered by biomass. The plant will produce Tencel and Veocel "eco-responsible" fibres, which are described by the company as more resource-efficient than virgin fibres, including lower usage of water and chemicals.^{324 325}

The wave of innovation and disruption sweeping the fashion industry reflect a recalibration of C-suite agendas and suggest fashion businesses will eventually overcome their sustainability challenges. The most powerful agents of change will be companies that have exceptionally high ambition, foster collaboration throughout their supply chains and are willing to jettison well-worn orthodoxies. These businesses can set a benchmark for peers, and even for other sectors. Indeed, as the world moves towards a greener economic model, ambitious brands can leverage the industry's weak performance to catalyse materials transformation and establish themselves as sustainability leaders.

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Puma: Moving Sustainability Beyond Marketing



Yeung Chi Kin

Anne-Laure Descours Chief Sourcing Officer, Puma

The German sportswear brand's chief sourcing officer, Anne-Laure Descours, is on the front line of Puma's efforts to operate more responsibly. As scrutiny of fashion's "green" claims mounts, she says brands must focus on walking the talk on sustainability.

— by Sarah Kent

Bold eco-friendly claims and ethical sourcing promises have become staples of fashion's marketing strategies alongside growing consumer interest in sustainably branded products. It's also an area that's attracting mounting regulatory scrutiny, with a broad crackdown on "greenwashing" pushing brands to back up any sustainability claims and rethink how they communicate about targets and progress.

Puma has focused on sustainability disclosure longer than most, introducing and publishing metrics on its environmental impact a decade ago. With time running short to meet global goals to curb climate change, brands need to focus on

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finding and explaining solutions, rather than quick marketing wins, says Puma's chief sourcing officer Anne-Laure Descours.

It is becoming increasingly important for companies to speak to consumers and other stakeholders, like investors, about what they are doing to operate more sustainably. But what companies say is also becoming more scrutinised. How do you navigate that?

Nobody's sustainable today. We are all trying to become more sustainable. So what can you communicate? You have to be realistic as to what you are really doing.

We should be very careful not to say, "We are the best," because nobody is the best and nobody is good at that game today. We are all learning, and we are all developing, and we are all trying.

It's a constant improvement process. So how you communicate has to remain extremely humble. It's a lot about being very humble and being very transparent.

Having said that, the complexity at the back is so big that at times, you might make a mistake in communication, not because you want to mislead anybody but because you don't know what you don't know. There is a lot, a lot of learning at the moment, collectively.

It's a journey, and I think being honest on where we are in the journey, being transparent, and recognising that we are not where we would like to be, ... and we need to do more collaboration, and we need to bring more learning. I think this is the only way.

Do you worry that companies could pull back from what they're doing because it's becoming more regulated, because there are tighter requirements around what you need to demonstrate in order to make claims?

I find it personally interesting, and helping us in a way, when the regulators start to frame what we are doing, because then ... we need to upgrade the way we do things. We need to upgrade not just us, but also our partners to make sure that what we do and what we communicate are really reality.

So there might be from brands or from the industry, a moment where there will be less communications on sustainability. But I think it's about time that we structure the industry. ... I think that's the objective here: that the way everybody will communicate is the same, based on the same rules.

An area that both regulators and industry advocates are scrutinising closely is the way the industry calculates and discloses its environmental footprint. There's been particular criticism of the Higg Index, a tool commonly used to measure impact. How do you navigate the current landscape, when a tool that's widely accepted within the industry is being questioned?

For sure, there will be a need with the regulators to set up a standard and a system to calculate, which is manageable. If everybody comes with their own tools, all the objective to bring transparency will fail. We need to make sure there is one tool for everybody, so we can compare everybody.

I think everybody has been building quite a robust programme at the back, especially when you are engaged within your supply chain on this. So the data access, I won't say it's 100 percent there, but we are getting there. It's how you're going to report, and you need to have the same set of reporting tools for everybody, so it becomes reliable for the consumer, and reliable for the regulators.

"That's the objective here: that the way everybody will communicate is the same, based on the same rules."

From a strategic standpoint, obviously there's regulatory changes that are setting a direction, but from a brand positioning point of view, do you see this as something that is just going to be necessary to meet consumer expectations?

If you don't believe this is the right thing to do, and you're being forced to do it, you can't make it happen. You really have to believe in it.

When I started in this business 35 years ago, as a buyer and then moving to sourcing, making a T-shirt was very simple. It was about getting the fabric to a factory, cut the fabric, sew the garment and ship it. That was it.

[Now] it's definitely much more complex and wider, and the level of knowledge I need to have to manage a business is much bigger than it used to be. ... I train myself every day. I read a lot. ... We have all these groups within the

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industry where we speak to each other. My suppliers, I can tell you, are educating me big time.

[That goes] for everybody. ... The entire organisation has to have basic knowledge. ... We spend a large amount of time at the moment, trust me, to engage with the sales guys, the finance guys, the IT guys, so everybody has the same level of understanding [of] where we are going, and what needs to happen. It's a lot of education.

This is a complex topic, but consumers want a simple answer and they also want it to be 100 percent accurate. It's very difficult if you're trying to simplify something very complex. How do you square that circle?

There is a need to make it digestible to the consumer, so they don't have to work.

The other day we looked up how many data [points] you have to have for one tee, or for one product. It's over 1,000 data [points] to be compliant. So the amount of information, the amount of process you have to have at the back is just becoming bigger and bigger.

It's not about marketing; it's about explaining. ... We need to work on simplifying it and making sure people can be part of the conversation. With the younger generation, they don't have the [knowledge] base, so how do we engage, or how do we bring their expectations and how do we connect with them in simple ways? It's complicated, not easy.

I think to me just as a first idea is getting some of the younger generation willing to go on the



A Puma sneaker. Unsplash.

journey with us, so they can become, not the ambassador, but the voice of explaining in a simple manner what we're talking about.

At the end of the day, I think we definitely need to tell the story much better, but in a transparent and realistic way.

Are you optimistic that the industry will be able to deliver on real change within the time frame left?

It's a race. We know it's a race, and we know we need to act fast and I think I spend at the moment more than half of my time on sustainability topics, at least.

[But] it's not a one-brand conversation.

The biggest change I'm seeing right now, and it's truly

accelerating, is that awareness that we need to do it together... Nobody can do it alone. It's far too complex and it's far too big.

The way you build your supply chain has to become very engaged with your partners. From a transactional way of doing business, you have to go into a real collaboration way of doing business.

I can tell you when I speak to my friends and competitors, there is a lot of positive energy between us, and there is a lot of common ambition or common desire, and passion to fix it.

This interview has been edited and condensed.

08. FUTURE-PROOFING MANUFACTURING

Continued disruptions in supply chains are a catalyst for a reconfiguration of global production. Textile manufacturers can create new supply chain models based around vertical integration, nearshoring and small-batch production, enabled by enhanced digitisation.

KEY INSIGHTS

1. Macroeconomic pressures continue to weigh on fashion's global supply chains. More than half of fashion executives believe supply chain disruptions will be one of the top factors impacting growth of the global economy in 2023.
2. In an attempt to avoid transport bottlenecks and political or social instability, 65 percent of fashion executives are considering nearshoring, creating new manufacturing hubs dedicated to serving US and European demand.
3. Navigating supply chain disruptions will require brands to work closely with their manufacturers: about 60 percent of fashion executives are considering forming strategic partnerships with their suppliers.

EXECUTIVE PRIORITIES

Dial up speed and flexibility

Strategies like vertical integration, nearshoring and small-batch production enable brands to better respond to shifting market and customer demands while reducing inventory costs.

Invest in digitisation

Significant cost advantages can be gained across the production process by investing in tools such as automation and digital end-to-end integration of data.

Collaborate strategically

Brands and manufacturers should establish strategic partnerships to make investments required to future-proof their operations, achieving greater agility and visibility and reducing environmental impact.

The fashion industry operates on an outdated manufacturing system that is ripe for disruption. With many practices remaining unchanged for more than 50 years, fashion's supply chains are neither responsive nor sustainable enough. With brands hunting for the lowest prices, manufacturing practices have become fragmented as brands outsource more and more of their production to sprawling networks of suppliers in developing countries. The number of factories has mushroomed, along with unauthorised subcontracting.

At the same time, logistics gridlocks and macroeconomic pressures continue to weigh on global supply. The war in Ukraine forced the re-routing of trade and triggered an energy crisis, while ageing port systems across the globe are creating transport bottlenecks. Global inflation has pushed up input costs — cotton and cashmere prices have increased 45 percent and 30 percent year on year in 2021 respectively³²⁶ — and extreme weather is hitting developing economies like Pakistan where, alongside the tragic loss of human life, as much as 45 percent of the country's cotton crops were wiped out by floods in August 2022.³²⁷ As such, more than half of fashion executives in the BoF-McKinsey State of Fashion 2023 Survey identified supply chain disruptions as one of the top risks hampering the growth of the global economy in 2023.³²⁸

Meanwhile, the softening of consumer demand is causing many brands to reduce their order volumes, squeezing manufacturers' revenues. In a 2021 McKinsey survey of apparel chief purchasing officers, 66 percent said they anticipated increased volatility in consumer demand.³²⁹ If these and other pressures continue, margins across apparel manufacturing are expected to shrink 10 percentage points by 2030.³³⁰

Amid the diverse sources of pressure on fashion's supply chains, the system is beginning to show signs of change. To future-proof their organisations, manufacturers are adapting to

the needs of fashion brands seeking increased flexibility and shorter lead times so that they can accommodate swift changes in consumer demand and unpredictable logistical disruptions. Enabled by enhanced digitisation, they will lean into new supply chain models based around vertical integration, nearshoring and on-demand systems.

From Suppliers to Partners

To mitigate risks and increase control along supply chains, some manufacturers are joining forces with producers from different specialities. For example, US textile manufacturer Mount Vernon Mills acquired a yarn spinning and weaving facility from Wade Manufacturing Company, also US-based, in a bid to gain more flexibility over its production.³³¹ In Asia, Sri Lanka-based manufacturer MAS Holdings in August 2022 acquired the assets of Bam Knitting, one of the country's fabric producing and finishing operations.³³²

Vertical integration can help cut costs, improve margins and prevent delays across production. Similarly, consolidation of players across the supply chain has added to the deal-making. In Italy, Gruppo Florence was formed in 2020 to create a production network comprising more than a dozen small and medium-sized luxury specialists, from hat makers to jersey makers.³³³ Such deals are expected to continue in 2023.

Investments and partnerships can also foster industry innovation by connecting brands and manufacturers with innovative fabric and yarn suppliers to help bring new textiles to market. For example, athleticwear brand Lululemon's anti-odour Silverescent fabric is the result of a partnership with materials company Noble Biomaterials.³³⁴ This can also enable new materials to scale. Fashion group Inditex announced in May 2022 that it had agreed to buy 30 percent of Infinited Fiber Company's production of its textile waste fibre each year for three years, facilitating Infinited's plans to set up its first large-capacity factory.³³⁵

Several brands have prioritised sustainability-related innovation, using partnerships with fibre producers to bring recycled or circular materials to market. H&M partnered with another Swedish company — textile recycling innovator Renewcell — in 2020 to incorporate more recycled fibres into its products.³³⁶ Similarly, US brand The North Face works with Finnish sustainable textile material company Spinnova to source its circular fibre made from wood and waste.³³⁷ To scale these materials, manufacturers will need to modernise their operations in tandem and in partnership with brands.

In the luxury segment, where labour can be more skills-based than in other segments, brands have secured access to craftsmanship through manufacturer acquisitions. For example, Italian sneaker brand Golden Goose announced in October 2022 that it would acquire its main supplier of seven years, Italian Fashion Team,³³⁸ and LVMH-owned Fendi said it has taken a majority stake in Italian knitwear maker Maglificio Matisse.³³⁹ Since 2015, Chanel has acquired eight manufacturers, including Italian knitwear supplier Paima. While providing the French luxury label with greater certainty in terms of supply of materials, the acquisition strategy also grants Chanel greater access to innovation.³⁴⁰

Closer to Home

Another shifting dynamic in fashion's supply chains involves nearshoring. By moving manufacturing closer to consumer markets, brands can increase their speed to market while reducing the cost of transport and duties and mitigating various risks, including those related to inventory.

In 2020, MAS Holdings opened a manufacturing facility in Kenya so that the business could take advantage of the preferential trade agreements (AGOA) in place with the key consumer markets of the brands it serves;³⁴¹ the facility manufactures apparel for PVH Corp., which

owns brands such as Tommy Hilfiger and Calvin Klein.³⁴² Meanwhile, South Korea's Sae-A Group has opened two spinning mills in Costa Rica, the most recent in 2022, citing the political and social stability of the region as its appeal.³⁴³

Many fashion players are expected to continue to produce garments in historically low-labour cost manufacturing countries such as Bangladesh and Pakistan, but nearshoring will remain on executive radars. In the BoF-McKinsey State of Fashion 2023 Survey, 65 percent of fashion executives said they were considering nearshoring to address supply chain challenges.³⁴⁴

These shifts are creating new manufacturing hubs dedicated to serving US and European demand. In McKinsey's annual survey of chief purchasing officers, over 75 percent of North American respondents said they expected to increase the share of sourcing from Central America, while more than 35 percent expected to increase the share from Mexico.³⁴⁵ In Europe, Turkey is emerging as the preferred closer-to-home hub, with 85 percent of Western European respondents expecting to increase their supply from the country, followed by Eastern Europe and Northern Africa.³⁴⁶

Spanish brand Mango has said it will move some production in China and Vietnam to Turkey, Morocco and Portugal,³⁴⁷ while US footwear brand Steve Madden moved half of its production from Vietnam to Brazil and Mexico in 2021.³⁴⁸ In Brazil, footwear exports jumped 32 percent year on year in 2021.³⁴⁹ Similarly, the value of denim imports to the US from Mexico increased 50.58 percent in the first eight months of 2021, compared to the same period the prior year.³⁵⁰

Sourcing from closer-to-home locations can create environmental benefits, too, for instance by reducing greenhouse gas emissions and energy use, as well as unlocking access to more sustainable materials and improving water stewardship.³⁵¹ With more than 70 percent of the industry's greenhouse gas emissions generated from upstream activities, some manufacturers are aiming to

decarbonise manufacturing and leverage their improved sustainability credentials to differentiate themselves from the competition.³⁵³

Nearshoring can be challenging to get right, however. Because raw materials suppliers are located close to traditional production regions, moving production nearer to home for many Western brands can make it difficult to source materials. For speciality manufacturers, like dyers and fabric makers, a location's lack of technical skills can also be a concern. Manufacturers will need to rethink their processes to make nearshoring successful; simply moving operations will not be effective.

While rare, some fashion brands are investing in moving some production to their domestic markets. Boston-based sportswear label New Balance opened its fifth manufacturing facility in the US in 2022 and has promoted "Made in USA" collections.³⁵⁴

The uncertain economic environment may prompt brands and manufacturers to postpone or downsize nearshoring strategies in the short term, given that manufacturing hubs in Asia are expected to remain significantly cheaper than other locations. It should be noted that nearshoring can also threaten economic prosperity and job creation in traditional manufacturing hubs, which would be negatively impacted if their manufacturing activity were to diminish. Brands should understand the full scale of its decisions and work with manufacturers to pursue nearshoring with good governance and ethics top of mind.

Building Responsiveness

Regardless of how suppliers diversify production capabilities or global footprints, increased digitisation will enable them to support the changing needs of brands. In a 2021 McKinsey survey, apparel chief purchasing officers cited capacity planning, virtual sampling and supply chain transparency among the key areas for digital

investments in the next five years.³⁵⁵

In pre-production, digital platforms are helping brands source fabrics and create digital samples, saving time and money and reducing waste. In post-production, digital looks are facilitating quality control and improving the flow of information between suppliers and brands.

While these innovations are modernising discrete parts of the value chain, linking them together in a digitally integrated journey remains a challenge. However, new platforms are emerging that digitally connect key parts of the production process. In China, Alibaba manages a manufacturing platform that connects shopping demand on sites Taobao and TMall with production information. Consumer insights are gleaned from its website, where AI algorithms and cloud technologies provide real-time analytics that manufacturers can use to streamline production and optimise inventories.³⁵⁶ Similarly, fast-fashion player Shein designs and manufactures products in small batches using a trend-prediction model and monitors performance in real time to adjust production up or down accordingly.³⁵⁷

While these innovations are modernising discrete parts of the value chain, linking them together in a digitally integrated journey remains a challenge.

Some fashion brands are looking for suppliers that can accommodate small-batch production. This requires manufacturers to invest in capabilities like 3D sampling, automated sewing and knitting, 3D and digital printing, direct-to-fabric and direct-to-garment printing, as well as automated post-production logistics to finalise orders.

In terms of the adoption of automation, the fashion industry lags other sectors, such as

electronics and auto-making. However, suppliers that make a case for investing in automation will be able to differentiate themselves from competitors by facilitating faster and smaller-batch production. More than 50 percent of chief purchasing officers said they expect automation to become a major driver for sourcing decisions by 2025.³⁵⁸

In the year ahead, both brands and suppliers should prepare to work more collaboratively than they have in the past, moving away from transactional relationships to deeper partnerships that enable both parties to benefit from innovations and mitigate risks. About 60 percent of fashion executives in the BoF-McKinsey survey said they

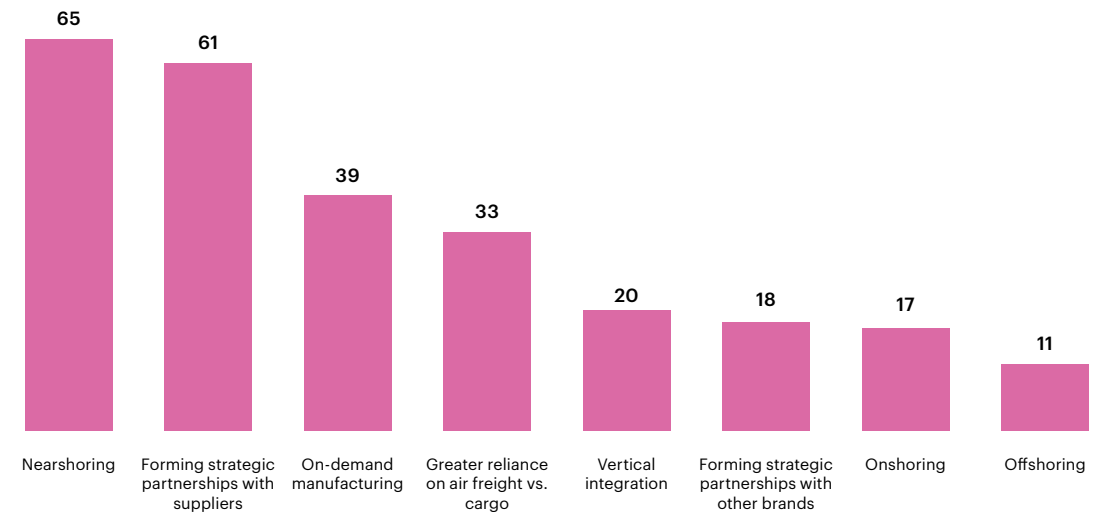
considered forming strategic partnerships with suppliers to mitigate supply chain disruptions. Collaboration can come in many forms, from co-financing and capability sharing to rewards and other incentive systems.

While manufacturers are likely to be cost-conscious in 2023, developing capabilities for nearshoring, small-batch production and digital production processes will help them establish a competitive advantage and will make them less reliant on price as a bargaining chip in building relationships with brands.

Exhibit 16:

Executives are considering nearshoring and strategic supplier partnerships to address supply chain challenges

Strategies being considered to achieve greater supply chain security, % of respondents



Source: BoF-McKinsey State of Fashion 2023 Survey

MAS Holdings: Deconstructing Supply Chain Risks, and Rewards



Suren Fernando
Group Chief Executive, MAS Holdings

As its global apparel manufacturing footprint expands, Sri Lanka-based MAS Holdings is homing in on supply chain risks to help its brand partners weather oncoming economic turbulence. Building resilience together is more critical than ever, says group chief executive Suren Fernando.

— by Janet Kersnar

Being the head of South Asia's largest apparel manufacturer arguably gives Suren Fernando a unique vantage point from which to observe the recent ups and downs of global supply chains, having spent the past two years of his lengthy career at MAS Holdings as chief executive. The textile and apparel manufacturer and exporter was founded more than 30 years ago in Sri Lanka, a country that has suffered extreme economic hardship in 2022,³⁵⁹ with inflation running as high as 70 percent and chronic shortages in everything from fuel to food, triggering political turmoil. It's likely no surprise then that global risk mitigation is top of mind for the executive of the design-to-delivery company whose operations stretch across

53 manufacturing facilities in 17 countries, with approximately 115,000 employees.

Fernando believes that one of the keys to the success of the family-owned, business-to-business company, which he expects to record revenue of \$2.4 billion in 2022, is its long-lasting partnerships with a range of global brands, from Victoria's Secret to Nike. Another key is its ability to embrace the evolution of supply chain models over time, from the traditional singular focus on cost optimisation to today's emphasis on building strength and resilience, be it through vertical integration, nearshoring or pushing the boundaries of on-demand manufacturing. Ultimately, Fernando said, not least because "as a manufacturer, you're only as strong as your supply chain."

Since the pandemic, the fashion industry has felt the acute challenges of what happens when supply chains break down. What has this meant for best-in-class supply chains?

Historically, supply chains — at least in our industry — were organised mostly for cost optimisation, looking at where you can source different components, at the lowest possible price and identifying the country that's going to assemble products at the lowest manufacturing cost. That model worked very well for many years. It did put manufacturers like us under pressure to be cost-competitive, but the model fundamentally worked.

Over the last two years, with this level of churn that we see in the external environment,

the dynamics have changed significantly, and certain things that we took for granted have been questioned or even broken down. At the same time, you are dealing with new challenges, and new opportunities. Now the key theme that comes out of all of this is: how do you manage yourself more effectively for risk? And, therefore, agility and resilience play such a pivotal role in this regard.

At a practical level, what does managing risk — and building more agility and resilience — mean for MAS and your customers?

A few years ago, MAS was predominantly supplying everything out of Sri Lanka. Today, we have a much broader manufacturing and sourcing footprint. Our largest manufacturing base is still in Sri Lanka, but we have a significant presence now in Indonesia, Vietnam, Bangladesh, India, Jordan, Kenya and Haiti, as well as a value-added service and a trading operation over in North Carolina in the US.

Our geographic expansion generally starts by working with one or two "anchor" customers, to understand what they want strategically, what they might see in a particular region. For example, if it's Indonesia, it might be to take advantage of the availability of labour, and it has become an attractive sourcing destination if you are supplying to countries such as Japan or Australia, where they have preferential duty agreements. So it could be driven by duty, speed or proximity to market, or as before, cost advantages.

Where will nearshoring

fit into this? As many fashion executives already understand, it's one thing to want to adjust their companies' global footprints and bring supply chains closer to their key markets; it's another to actually be able to do it.

Nearshoring is certainly on the radar of our customers, but now for slightly different reasons than before, and it carries its own risks. When nearshoring initially became a big topic six or seven years ago — even if it was just conversations happening at a very strategic level — the value unlock was clear to [MAS] customers, for two reasons: speed — for example, because it brought them closer to markets — and costs — because, for example, it may have brought certain preferential trade agreements. In these post-pandemic times, customers have also realised the importance of nearshoring as a form of risk mitigation.

But companies [looking to move supply chains closer to key markets] often underestimate the differences between [markets]; what is in one location [cannot be easily] replicated in another — things like compliance standards, be it environmental or social; education; technical skills, or service levels are not the same, and so on. So like I said, over the past few years, we've been able to navigate most of these challenges to organise ourselves differently.

When we [at MAS] embarked on a nearshoring strategy, we realised that there were certain limitations in executing it — specifically the sourcing of raw materials, the right talent and the technical skills to set

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up manufacturing operations weren't always available. Over the last couple of years, we've been able to address these challenges to a certain degree [by building on-the-ground capabilities]. We now have a much better understanding of the sourcing capabilities available in certain regions, and local challenges.

When we set up initially, we always have a fairly large core team or a tag team that will go out from Sri Lanka to set up the factory, we send certain people who have technical expertise and knowledge about quality, manufacturing techniques and so on. Our strategy has been to over-resource from Sri Lanka at the start to make sure that we set it up right, and then over a period of time, phase out the Sri Lankans and take on more local talent. Depending on the country, it might take longer. For example, in Haiti [where MAS has been since 2017], we still had to manage with a fairly large amount of Sri Lankans because the technical knowledge and experience that's available in the country are quite limited.

But like I said, when you address a certain challenge or a risk element [when nearshoring], it also exposes you to certain other challenges that you have to manage. Having said that, our experience in the Americas has been good thus far.

Another big topic in post-pandemic fashion is on-demand manufacturing, which promises a way forward in terms of tighter inventory management. How has this played out for manufacturers like MAS?

On-demand takes two forms,

which have different dynamics. For certain customers, we have what we call "speed models" or "read and react models," where the customer — generally a larger one — might put out a limited range with certain colours or styles, and depending on [how it] performs in the market, the customer will place a follow-up purchase order and they would want it at much shorter lead times.

Then you have the more personalised or customised product that we make on demand. We have experimented with several versions of this, even making products customised for a particular consumer. We have had some level of success, but I wouldn't say it's really taken off.

What we are looking at now is on-demand, for example, with a T-shirt, where we would send the "blanks" from Sri Lanka and then have a printing facility onshore to make that customisation or personalisation and supply the customer from that location. We have a lot of experience in dealing with our core business in on-demand, but on the personalisation and customisation part of it, we have the models in place, but it's been slow for customers to adopt.

MAS is all about vertical integration. How do you think the definition of vertical integration will evolve in 2023?

For MAS, vertical integration, or verticality as we call it now, has always been important. We were the pioneers in developing that supply chain capability [in Sri Lanka]. Verticality is all about mitigating risk and offering speed, agility and cost advantages to the customer.

Currently, in Sri Lanka, we source 50 percent to 60 percent of raw materials from within the island. We are able to source our own lace, our own bra cups, our own elastics, and so on, and even some of the accessories that go into making garments. It's always been an important piece for us, because as manufacturers, you're as strong as your supply chain.

Having the supply chain located very close to you and probably having a greater deal of influence over it certainly help us to read and react and respond to customer requests that much faster.

Sustainability has a role to play in supply chains today too. How do you prioritise discussions at MAS around sustainability?

We launched what we call our "Plan for Change" ... and have set ourselves 12 key targets to make sure that we achieve our ESG goals in the next three years. For example, if you look at product ... we strive to generate 50 percent of our revenue through products that have some sustainability element by 2025. We are probably close to 20 percent today, so we have a very aggressive target to go for. Being a business-to-business manufacturer, we have to do it in close partnership with our customers. This has been on our agenda for many years, but sometimes really pushing the agenda with customers can be challenging because while you have conversations on sustainable products, you also have conversations on cost. But especially over the last two years, we have seen almost all our strategic customers make sustainability a priority and that's really helped us to gain a lot of

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traction. So it's in their interest and in our interest to make sure that we achieve these goals jointly.

We are also mindful that in the very near future and maybe as soon as next year, there will be more regulation coming into play. Customers are pre-empting this and working closely with us to make good progress before it becomes mandatory and enforced.

Trust between manufacturers and brands eroded during the pandemic. What will be critical factors in 2023 to make sure that even as times get tough, trust remains on both sides?

One position of strength that we at MAS have is 20- or even 30-year relationships with most of our larger customers, so there is a level of trust that has become mutually rewarding.

We have not been as close to the customers as we were previously, due to the pandemic and the limitations of travel.

As a supplier, we've always lived by our values, extremely high standards of compliance and governance and the right mindset to work with these customers with clear lines of accountability. Accountability goes way beyond ensuring that the products are made right and made well, especially in terms of the high standards of compliance and ethical standards that we practice in the business, and we've made them very transparent to our customers. Our door is always open for any customer to come and see the standards and the practices that we have internally in our business.

You've just finished two years as CEO of the entire company — having been CEO of a big MAS division before that. As you start your third year, what's keeping you awake at night?

One [challenge] primarily has to do with the softening market conditions, with volume looking poor because of inventory situations [due to companies with large amounts of stock on their hands] and consumers are facing certain pressures on pricing. We see this continuing maybe for quarter one, quarter two of next year.

Another is attracting, developing and retaining talent. ... It's a global phenomenon with talent. People move jobs and some even don't want to continue the way that they worked before the pandemic. So really managing talent becomes a critical piece for me and the senior team.

This interview has been edited and condensed.

09. DIGITAL MARKETING RELOADED

Recent data rules are spurring a new chapter for digital marketing as customer targeting becomes less effective and more costly. Brands will embrace creative campaigns and new channels such as retail media networks and the metaverse to achieve greater ROI on marketing spend and gather valuable first-party data that can be leveraged to deepen customer relationships.

KEY INSIGHTS

1. Privacy regulations and technological changes have reduced the effectiveness and driven up the cost of paid digital marketing, meaning brands spent more than three times the amount to acquire each customer in 2022 than in 2013.
2. Brands are bolstering creative capabilities and adapting channel strategies. Marketing budgets are shifting to alternative channels, such as retail media networks. Spending on RMNs is expected to reach \$100 billion by 2026.
3. Valuable customer data is still up for grabs. Over half of customers said they are more likely to share data if they receive something in exchange, like personalised recommendations; brands that innovate the customer experience will have a significant advantage.

EXECUTIVE PRIORITIES

Bolster creative capabilities

To support the demand for higher volumes of fresh content in diverse formats, brands need to hire for, or outsource, creative production capabilities.

Revisit channel strategies

Offset the reduced ROI of existing paid digital marketing channels with alternative approaches like content marketing, influencer collaborations and retail media networks.

Prioritise first-party data

Gather customer data through transparent, direct communications adhering to regulatory guidelines such as GDPR, and offer customers something of value in return, such as loyalty discounts or exclusive access, then strive to create communities.

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Digital marketing playbooks have been turned upside down by recent data privacy changes, mandating an existential shift for fashion brands that once relied on customer targeting tools offered at scale by Silicon Valley's tech giants. Third-party ad targeting, social media growth hacking techniques and early iterations of loyalty programmes and personalisation had been important contributors to the rise of digital marketing and e-commerce brands.

But a new era has arrived, requiring brands to rethink how they reach new consumers and engage with existing ones. Instead of pushing content to pre-selected groups, as was so effective over the last decade, the key now is to pull in customers with a fast-paced stream of creative campaigns. Once brands have access to valuable first-party data, they can prioritise channels that deliver a strong return on investment and enable them to build deep, long-lasting relationships and foster communities among customers.

The disruption of the digital marketing playbook is a culmination of several years of regulatory and technical shifts that targeted online privacy and security risks. The EU's General Data Protection Regulation and the California Consumer Privacy Act — landmark laws rolled out in 2016 and 2020, respectively³⁶⁰ — have given users more agency over their data. Meanwhile, Apple's iOS 14 software update in 2020 allowed users to opt out of tracking across apps and websites.³⁶¹ And as part of its privacy initiatives in 2022, Google plans to discontinue third-party cookie tracking in Chrome, which commands 65 percent of global web browser market share.³⁶² When given a choice, many consumers are declining tracking: a McKinsey survey found 41 percent of users said they opted out of cookies.³⁶³

As a result of the tracking limitations, customer acquisition costs have spiked, rising on average 70 percent on TikTok and 39 percent on Meta platforms.³⁶⁴ In 2022, advertisers spent about \$29 to acquire each customer, compared with \$9

in 2013.³⁶⁵ All together, these changes signal a new reality: the era of third-party digital targeting is over. Brands will need to find different ways to differentiate their marketing strategies, broadening their social platform use beyond bottom of funnel ads, and focus on creativity and quality of the customer experience.

Reaching Customers: Content is King

Winners in the year ahead will embrace creativity and experimentation to stand out in the glut of online content. The updated approach will mirror some of the strategies from the golden age of advertising running from the 1960s to the late 1980s,³⁶⁶ when campaigns competed on creativity and quality to capture audiences. However, the internet requires both a faster pace and a wider range of mediums, particularly video used in multiple ways. The lifecycle of a digital campaign can be as short as two to three weeks before the impact dissipates due to repeated views by users.

To meet escalating digital content demands, brands are looking outside their organisations for creative development and dissemination. As such, influencers are already key partners for many fashion advertisers, with brands tapping their content-creation skills and accessing their loyal audiences. But competition for top influencers can be stiff, as well as expensive. Spending on influencer marketing skyrocketed from \$1.7 billion in 2016 to \$13.8 billion in 2021.³⁶⁷ There are also risks involved, particularly if relationships sour or if the influencer is involved in a scandal or controversy. For many brands, though, the rewards outweigh the risks.

In some cases, fashion companies have elevated influencers to brand-defining roles that were once the sole domain of Hollywood stars and supermodels. Hugo Boss, for example, signed a multi-year agreement with TikTok personality Khaby Lame as a global brand spokesperson in 2022.³⁶⁸ Similarly, YouTube

star Emma Chamberlain has appeared in television advertisements, brand campaigns and collaboration for Levi's since 2021.³⁶⁹

Publications also have a new role to play in the content market, extending beyond traditional display and print advertising or old-school advertorials. Their customised features, video series or affiliate marketing links can validate brands and direct readers to e-commerce sites. Brands can also tap the publishing house's creative teams to produce sponsored projects. Digital streetwear and luxury publication Highsnobiety, for example, has a partnership with Gucci tied to its collaboration with The North Face.³⁷⁰ A video from the project, released at the start of 2022, featured TikTok star Francis Bourgeois.³⁷¹ When Zalando acquired a majority stake in Highsnobiety in June 2022, the e-commerce retailer said the publisher would act as a "strategic and creative consultant" to extend its storytelling capabilities.³⁷²

In recent years, many fashion companies capitalised on television streaming by partnering with productions for increased exposure. For example, Gucci provided access to its archives and allowed shooting in its Rome flagship for "House of Gucci," a film directed by Ridley Scott and starring Lady Gaga and Adam Driver, which generated 25,000 posts across news and social media in the months ahead of the film's release in 2021.³⁷³

Follow the Audience

Fashion brands will need to scrutinise their marketing strategies at the channel level to offset the declining returns of paid social and search channels. The greatest return on investment will come from channels that reach customers further down the marketing funnel where they have high purchase intent, as well as those that provide opportunities for brands to create direct, first-party relationships with customers.

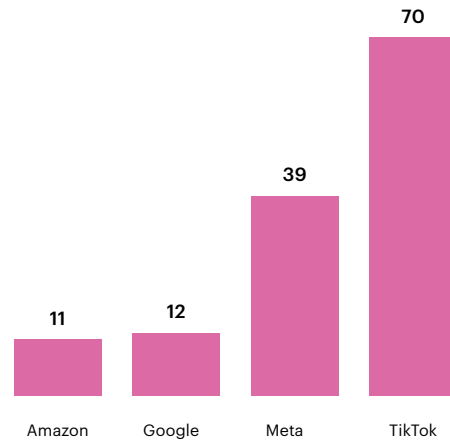
Multi-brand retailers over the past few years have increased advertising opportunities on

their websites, apps, emails and social channels as well as in-store aisles and displays. Following Amazon's ad strategy, players like Target and Ulta Beauty have deployed "retail media networks" in the US, which help brands benefit from proximity to the end of the purchasing funnel. RMNs also enable brands to gain access to retailers' first-party data for closed-loop reporting. This enables brands to run reports on the effectiveness of ads throughout a customer journey, from displaying the ad to purchasing a product.

Exhibit 17:

Performance marketing costs have increased significantly on major ad platforms in 2022

Year-on-year increase in cost-per-mile (cpm), %



Source: Business Insider

For many fashion companies, advertising with retailers is more efficient than other forms of performance marketing. Among apparel and footwear executives responding to a recent survey, about 80 percent reported somewhat better or significantly better performance of advertising



Vans collaboration with Roblox, Roblox.

on RMNs than on other marketing channels.³⁷⁴ Spending on these networks, including on Amazon, is expected to reach \$100 billion by 2026.³⁷⁵

Another rising marketing channel is the virtual worlds of the metaverse, ranging from gaming to immersive social environments. While the space is less developed than RMNs, the potential audience is growing and highly engaged — and allows brands to form first-party relationships with customers. As of August 2022, online gaming platform Roblox drew nearly 60 million daily active users, an increase of 24 percent year on year,³⁷⁶ leading brands like Vans to launch virtual worlds on

the platform.³⁷⁷ Brands that opt to pursue projects in the space will need to be disciplined to ensure their activations are more than one-off projects.

Meanwhile, blockchain-based web3 technologies such as non-fungible tokens can be deployed to build communities. Several brands have experimented with NFT collections, like Adidas' "Into the Metaverse" NFTs³⁷⁸ and Prada's "Timecapsule" NFTs.³⁷⁹ Brands will find the most effective web3 and metaverse projects offer users value or utility, such as rewarding them with exclusive access to gated products or experiences, which in turn create a stronger affinity for the brand.

Innovating Customer Relationships and Communities

Once a customer makes a purchase, brands need to focus on relationship-building, including examining how best to leverage customer data. While a privacy-first world creates near-term challenges, brands that build transparent, mutually beneficial relationships with customers are well-placed to realise huge benefits in the long term.

Even as the data-sharing environment becomes more restrictive, not all customers are opposed to giving brands access to personal information. According to a recent poll, over 50 percent of customers said they are more likely to share data if they receive something in exchange, such as discounts, sizing advice or personalised product recommendations.³⁸⁰

The reward for brands that build trust-based, mutually beneficial relationships with customers are the communities that grow around them.

Brands can both protect customers' privacy while incentivising them with value and services, such as personalisation. Using data to enhance a customer's experience can help brands to address rising online return rates by offering accurate sizing recommendations, for example. This is particularly critical for the fashion industry at a time when as much as 15 percent of returned online purchases is attributed to "bracketing," the practice of consumers ordering the same items in multiple sizes and colours.³⁸¹ Bolstering loyalty programmes can also drive meaningful benefits: nearly two-thirds of US consumers who are satisfied with loyalty programmes say they are more likely to increase the frequency of purchases.³⁸²

Customer data can inform product

development, too. When a skin care brand partnered with a retailer's RMN, it discovered through analysis of the RMN's data that consumers were interested in Korean skin care routines, and thus launched a line of products to tap that customer interest.³⁸³

The reward for brands that build trust-based, mutually beneficial relationships with customers are the communities that grow around them. For example, loyal customers can influence others by creating user-generated content, as seen with Gymshark's community of fitness enthusiasts who post large volumes of user-generated content showcasing the UK sports-apparel brand's products on social media. Gymshark nurtures this community with a dedicated "In Real Life" team that meets up with members at offline events.³⁸⁴

New Ways of Working

To win in world of fast-paced, customer-focused marketing, agile ways of working will become a necessity. By bringing together cross-functional teams that comprise marketing, product, brand, sales, analytics and insights, brands can rapidly iterate on effective creatives, channels and customer experiences.³⁸⁵

To ensure this new approach succeeds, brands need to invest in technology. Investments may include data systems, such as customer relationship management software, or digital asset management software that maximises the value of existing content by allowing brands to edit and re-cut existing material from their content libraries into new forms. Investing in centralised dashboards that monitor the impact of campaigns will help brands make quick, informed decisions to continuously improve their customer experience.³⁸⁶

How Web3 Is Shaking Up Digital Marketing

Proponents of web3 say the technology offers a new way forward for digital marketers looking to engage shoppers and build communities. A growing number of brands in 2023 will be experimenting with nascent web3 technologies like NFTs — and learning that careful nurturing is needed to thrive.

by Marc Bain



The team behind Adidas' "Into the Metaverse" NFT collection. Adidas.

Over the past year, non-fungible tokens, or NFTs, emerged as a promising new avenue for fashion brands to draw in shoppers and build membership communities, letting them interact in ways that are arguably deeper and more meaningful than simply having an email address.

A brand can engage customers who hold their NFTs — whether purchased or claimed free after buying a physical product — by rewarding

them with free items or exclusive access to gated products or experiences, using the crypto wallet containing their digital tokens as a unique identifier. NFTs linked to real-world goods can also serve to authenticate products and act as a gateway to related services, such as repairs.

NFTs are part of the world of web3, the nascent internet based on blockchain technology. Web3 proponents say they offer a way forward for

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fashion's digital marketers, who are contending with a number of challenges in reaching new audiences, including stricter data-privacy rules, rising customer acquisition costs and social media's rapid content cycle, to name but a few. (See Digital Marketing Reloaded on page 98.)

NFT technology is still young, so the web3 user experience can be clunky, and NFT buyers, who are a niche in the broader market for now, often judge tokens by whether they can be flipped for a profit.³⁸⁷ It's also still to be seen how useful NFTs can be for introducing a brand or its products to audiences it isn't already connected with — a top priority for digital marketers — and even if brands can build a community, it may require careful nurturing to thrive.

But some argue the days of cheaply buying attention online are over, and it's time brands begin building an approach in line with this new reality.³⁸⁸

"Marketers are going to have to learn this new playbook, where attention is more earned than bought," said Brian Trunzo, the metaverse lead for the Polygon blockchain. "In web3, there's a more pure way of speaking to a customer by incentivising them — by providing digital assets and benefits to them through NFTs."

Community Building With NFTs

Adidas was an early leader in fashion to embrace NFTs, partnering with influential web3 names Bored Ape Yacht Club, Gmoney and Punks Comic to release a collection of 30,000 "Into the Metaverse" tokens in December 2021. Each cost .2 ETH (Ether), or about \$800, at the time. Generating revenue wasn't the main point though for the German sportswear brand.

"It was to launch a new community, a new

IN-DEPTH

membership model," said Erika Wykes-Sneyd, co-founder of Adidas' web3 studio. (Adidas also shared the revenue from the NFT sales with its partners in the project.)

The brand has given its NFT holders exclusive physical products such as a tracksuit and beanie and recently allowed them to vote on the colour of an upcoming release (orange and bright pink were the choices). Most of the community activity happens in a server on the chat platform Discord dedicated to the project with about 60,000 members. Wykes-Sneyd said they plan to involve NFT holders more in the coming months as collaborators and co-creators, not just customers.

Members of the crypto community tend to be the biggest audience engaging with these NFT projects, but they're not the only ones.

Adidas' relationship with this community is different than the usual brand-shopper dynamic, largely because members are financially invested.

"These are truly stakeholders at this point," Wykes-Sneyd said. "They're rooting for us, trying to support the success of this project, and they want to see its success. And if they don't, they're going to let us know by selling and showing us the floor prices going down." (Floor price refers to the lowest cost for an NFT on the secondary market.)

So far the project has been successful in her view, and prices for Adidas' NFTs on the secondary market suggest customers are still interested. As of October 2022, they were selling for around \$700 on the marketplace OpenSea, which is below their initial dollar-equivalent cost but qualifies as fairly stable given the year's market turmoil that has sent cryptocurrency and NFT values plunging. Wykes-Sneyd emphasised, however, that Adidas is focused on long-term goals for its project and the community involved, not fluctuations of the market.

Prada has also used NFTs to build deeper relationships with customers, though it's taken a

different approach to distributing them. The Italian brand allows shoppers to claim them for free when they purchase physical pieces from its limited-edition Timecapsule collections, which release online for a short period each month. All of the NFT-linked drops so far have sold out.

The NFT holders congregate in a Prada Discord server with roughly 5,600 members. In September 2022, one Timecapsule NFT owner won a trip to Milan that included an invitation to Prada's Spring/Summer 2023 show, a tour of Fondazione Prada (the company's contemporary art and cultural institute) and other perks. Later in the year, NFT holders could attend the next "Prada Extends" event, a celebration of local culture and music, this time taking place in Miami.

The NFTs give Prada a "higher level of intimacy" with its community base, Lorenzo Bertelli, Prada Group marketing director and head of corporate social responsibility, wrote in an email.

"Web3 presents a unique opportunity to enrich our existing customer relationships and also to engage new and diverse communities," Bertelli wrote. "We envisage our NFT programme as forming an increasingly important component of our customer relations and community engagement strategies."

Members of the crypto community tend to be the biggest audience engaging with these NFT projects, but they're not the only ones. Prada's NFT holders range from "much cherished long-time Prada devotees, to curious newcomers, to web3-native participants," according to Bertelli.

As for Adidas, it made sure to bring a number of its established customers in, setting aside 8,000 of its NFTs in the initial sale for users of its Confirmed app, where it releases hyped products to its most engaged fans. Many of them were new to the crypto world, Wykes-Sneyd said.

Great Web3 Expectations

Managing a community and its expectations isn't easy. Bertelli said Prada has put "considerable effort" into expanding its capabilities in web3 and plans to continue investing to support more NFT



Prada's "November" NFT. Prada.

and community engagement projects.

Other NFT projects have encountered backlash when they have failed to meet expectations. RTFKT, a maker of virtual fashion and NFTs, publicly apologised to its community members when one of its hyped product drops encountered technical glitches that left customers waiting for hours trying to claim the items. Holders of Adidas' NFTs have become restless when the brand hasn't provided regular updates on what they can expect, airing their complaints directly to Adidas in Discord.

"We have a full-time moderation team of seven managing this community," Wykes-Sneyd said. "That for us is unfiltered, front-row access to what people are feeling and thinking, whether that's the good, the bad or the indifferent."

Of course, brands can use NFTs without having to build an explicit membership group. They could just treat them as a way to push incentives and rewards to the crypto wallets of holders to occasionally grab their attention and build loyalty.

One challenge all NFT creators face, though, is making sure customers have a reason to care about their NFTs in the first place. Ideally the tokens should have some reason to exist in themselves, according to Pierre-Nicolas Hurstel, co-founder and chief executive of Arianee, an NFT platform for luxury and fashion brands.

"The utility of an NFT should be native. It's a proof of something, so the question is: do you have a good reason to distribute a proof of something to someone? A proof of attendance, participation, ownership," Hurstel said.

Part of Prada's aim with its project is to offer a point of view only it can provide. Just as with the physical products they offer and their brand identities, brands need to distinguish themselves and give consumers a reason to want to associate themselves. As Polygon's Trunzo put it, "The closer a brand is to a commodity, the more difficult it will be to use web3 tools to capture the attention of would-be customers and then maintain them as fans."

But if brands are able to entice shoppers to want their NFTs, it arguably provides the

foundation for a deeper relationship than just collecting an email during checkout or the shopper following the brand on Instagram. Hurstel described NFTs as "zero-party data," as opposed to the third-party data gathered and sold by other platforms or first-party data a brand collects itself. It represents a relationship the customer has purposefully opted into, which also has the benefit of precluding data-privacy concerns, Hurstel noted.

He and others in web3 imagine a time in the future when a customer's crypto wallet becomes their public profile, with the NFTs they've collected from purchases and attending events becomes the way a brand identifies their interests. To reach this point will take time and much wider adoption of crypto wallets, however.

"This conversation around blockchain, solving for identity and empowering consumers to take control of their identity [where] they can opt in, it sounds ideal," said Trevor Testwuide co-founder and chief executive of Measured, a digital marketing analytics platform. "Deploying that right at scale, there's a lot of work to do to get there."

Brands like Adidas and Prada are among those that see enough potential to start now.

10. ORGANISATION OVERHAUL

Successful execution of strategies in 2023 will in part hinge on a company's alignment around key functions. Fashion executives need a new vision for what the organisation of the future will require, focusing on attracting and retaining top talent, as well as elevating teams and critical C-suite roles to execute on priorities like sustainability and digital acceleration.

KEY INSIGHTS

1. Though 97 percent of executives expect salaries and other SG&A costs to rise in the year ahead, they should resist the temptation to put talent and organisational projects on ice.
2. The Great Resignation continues to weigh heavily on the industry. 55 percent of executives cited the talent crunch as one of the top factors impacting their business in 2022.
3. Education and training typically generate a return on investment that is between two-and-a-half and three times higher than recruiting, boosting the business case for investing in skills gaps found in key areas like sustainability, IT and supply chain.

EXECUTIVE PRIORITIES

Reimagine the organisation of the future

New organisational structures are needed to adapt to industry changes. In tandem, certain roles should be elevated to ensure razor-sharp decision making and strategy execution.

Reinvigorate the C-suite

Having a diverse range of expertise and experience in senior ranks deepens the boardroom bench strength and signals clearly to stakeholders what the company is prioritising.

Elevate people teams

Human resource teams must be part and parcel of initiatives that foster not only upskilling and reskilling, but also cross-functional collaboration and a full range of retention programmes.

In 2023, fashion leaders have an opportunity to review their talent rosters and team structures. Despite the many challenges on the horizon, as inflation dampens consumer sentiments and costs spike for many companies, fashion leaders cannot put off the difficult work of reinventing their organisations.

As fashion companies chase growth in the unpredictable year ahead, talent and organisational structures will become a key differentiator in performance. This follows on the heels of the industry encountering unprecedented challenges – ranging from pandemic-enforced remote working patterns to supply chain turmoil – and forcing entrenched processes to evolve. Challenges will likely persist in 2023 – 84 percent of fashion executives in the BoF-McKinsey State of Fashion 2023 Survey expect the industry to worsen next year. This will have repercussions for their businesses; 97 percent expect their costs of goods sold as well as selling, general and administrative expenses to rise.

As fashion companies chase growth in the unpredictable year ahead, talent and organisational structures will become a key differentiator in performance.

It will be tempting to put investments in talent and operational improvements on hold to focus on navigating an economic slowdown. But the most successful leaders will balance short-term crises with long-term needs by prioritising new hires and elevating existing roles to position their companies for growth. In our survey, 55 percent of executives cited the talent crunch as one of the top three areas having the greatest impact on their businesses in the year ahead. Executives should work to align their organisations, from top management to frontline staff, around the key

strategic themes that will drive growth.

For some companies, the moment may call for elevating existing roles around critical areas like sustainability, even creating new C-suite positions that fill gaps in expertise within senior leadership.

For other brands, the greater need will be to build out existing functions, such as those supporting omnichannel strategies, and to empower them with expanded leadership roles that have increased decision-making responsibility and accountability. Human resource teams in charge of a company’s talent may be included in role expansions and elevations. When Chanel appointed Unilever’s chief human resources officer Leena Nair as its new chief executive in 2021, the fashion label signalled to people teams across the industry that they are strategic operators. “HR is no longer a backroom department,” said Nair in an interview before her appointment. “It’s a vital part of running any successful business.”³⁸⁹

A Rippling Effect

The talent market is ripe for a reset. The sharp increase in voluntary attrition since the beginning of the Great Resignation of 2021 surfaced a deep fissure between companies and their employees – in the US, for example, it has led to 25 percent higher voluntary resignation rates than pre-pandemic levels.³⁹⁰ According to a recent McKinsey survey, 76 percent of people who left consumer retail jobs since the start of the pandemic entered another sector, the highest exit rate of any industry.³⁹¹

Half of fashion professionals believe the industry has lost the appeal it once had³⁹² as other sectors like technology eclipse it, in terms of career growth opportunities and pay.³⁹³ The exodus can also be observed in C-suites as top executives depart for roles outside of the fashion industry.³⁹⁴

The employee exodus is unlikely to reverse completely as economic conditions worsen in the year ahead. Retail workers remain difficult to retain, with 50 percent of US frontline workers

and 63 percent of retail managers reporting they are considering leaving their jobs.³⁹⁵ Many people are quitting because they are seeking better opportunities for career advancement, greater work-life flexibility or higher pay.³⁹⁶ Companies will feel more pressure to offer clear advancement paths along with prioritising culture, employee wellness and flexibility to attract top talent, whatever the role or seniority.

Meanwhile, the industry still needs to address diversity, equity and inclusion, including in top management positions. DE&I experts suggest that the industry’s work has only just begun when it comes to racial and ethnic diversity.³⁹⁷ Male candidates made up 76.9 percent of all CEO appointments in the fashion industry in 2021, according to retail merchandising company Nextail.³⁹⁸ Less than one-third of board positions are held by women at UK-listed fashion retailers, according to an annual survey from Drapers.³⁹⁹

The New C-Suite

As fashion companies prepare for the challenges ahead, some are rethinking the structures of their senior teams, taking the opportunity to introduce new or adapted C-suite roles that focus on increasingly critical areas such as diversity, sustainability or logistics.⁴⁰⁰ Among other benefits, these appointments send a signal to the rest of the company, shareholders and customers about where the leadership is focused for both the short and long term.

One C-suite role gaining traction in the industry aims to help address companies’ sustainability practices.⁴⁰¹ The C-suite teams at almost all of Europe’s 25 biggest fashion companies can count at least one executive with environmental, social and governance experience.⁴⁰² These leaders design and execute a range of sustainability strategies, from cutting carbon footprints to reducing waste to improving labour relations. Chief sustainability officers are

most successful when they are integrated into the rest of the business. Rather than creating an entirely new role, some companies are introducing a sustainability component to an existing one.

UK-based fast fashion retailer Primark, for example, put Michelle McEttrick, who is the company’s first chief customer officer, in charge of leading its sustainability strategy.⁴⁰³ These roles can also open the door to the top C-suite job. At Swedish fast-fashion company H&M, for example, Helena Helmersson was appointed chief executive in 2020 after serving as the company’s head of sustainability.⁴⁰⁴

Supply chain roles are also gaining more prominence in the C-suite, largely due to the increasingly complex nature of manufacturing today. Chief supply chain officers are the strategic bridge connecting manufacturing, procurement and sales, and operations and planning, while serving as a conduit for robust risk management and mitigation. Their work requires a wide view across departments to respond to crises, enable their companies to innovate production strategies and recruit specialised logistics talents.^{405 406}

Another C-level bridge-building position is the chief omnichannel officer, a role that consolidates offline and online channels under one operational umbrella as brands re-evaluate brick-and-mortar strategies alongside e-commerce and other channels. For instance, Parisian label Isabel Marant appointed a new chief omnichannel officer in September.^{407 408} Meanwhile, new chief experience officers, chief brand officers and chief technology officers are charged with overseeing and unifying customer experiences across distribution channels at companies like Under Armour, Moncler and New Look.^{409 410 411}

Even outside the C-suite, many fashion companies are investing in digital and data expertise with a view to becoming omnichannel-first organisations and achieving enterprise-wide digitisation. At consumer companies appearing in a ranking of top places to work, half of executives in a

survey said their businesses integrate digital teams across functions and geographies. In contrast, only 26 percent of respondents at companies further down the ranking could say the same.⁴¹² The companies that ranked highly were also 1.4 times more likely than their low-ranking counterparts to maintain digital teams in-house rather than outsourcing.⁴¹³

Meanwhile, fashion executives have an opportunity to bolster teams responsible for communication strategies at a time when their companies may be expected to take a stand on sensitive topics impacting society at large, such as the war in Ukraine. Institutional communications and liaison roles will require specialist knowledge around areas like climate change, trade policy and data privacy. These roles will be critical in ensuring brands are able to make meaningful contributions to not only trade organisations, but also cross-industry forums and policy-making bodies.⁴¹⁴

LVMH, for example is an official partner of the World Economic Forum in Davos, while Kering’s chief sustainability officer is also head of international institutional affairs.⁴¹⁵

As the fashion industry intersects with government regulations that have a high potential of impacting business operations, communications and public relations teams will have a larger role to play.

For consumer-facing communications on complex social issues, these teams will need to understand the shifting concerns of diverse audiences and collaborate with other internal teams – such as diversity and inclusion executives, marketing strategists and sustainability specialists – to craft campaigns and messaging.

Preparing for Change

Even amid these times of tighter cost management, fashion companies will need to prioritise investment in new skills and collaborative structures. A successful talent strategy will

require hiring and reskilling, pushing human resource teams to identify current and future skills shortages and set a strategy to address them.

Nearly 90 percent of executives foresaw a skills shortage in their organisations, according to a 2021 survey, yet only one-third said hiring plans were robust enough to address talent challenges. In 2022, fashion executives cited supplier management, artificial intelligence and automation, and omnichannel customer experience as the top capability gaps in their organisations.⁴¹⁶

Competition will be stiff across the industry for the most in-demand roles. These include specialists in ESG compliance, including lawyers who are focused on international law and can help companies navigate evolving ESG-related regulations. Supply chain and operations leaders are also sought after, as are support roles like merchandising assortment planners as well as specialists in logistics and pricing.

There is plenty of scope for upskilling and reskilling, with the twin benefits of serving as a retention tool and improving a company’s competitiveness. The business case even in economically uncertain times is sound: education and training typically generate return on investment that is between two-and-a-half and three times higher than recruiting, according to McKinsey research.⁴¹⁷

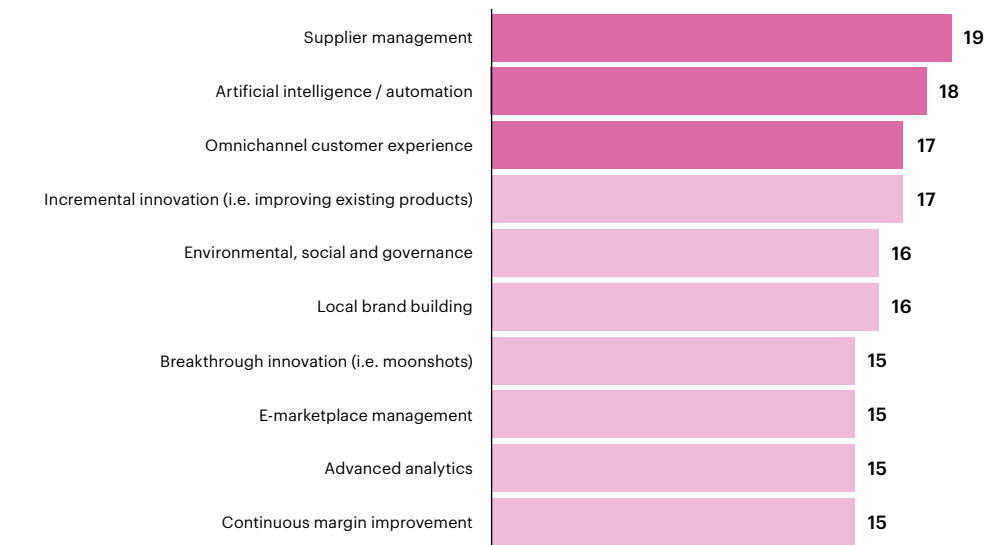
This has not been lost on big companies that are already investing heavily to educate employees.^{418 419} Amazon, as part of its “Upskilling 2025” initiative, is investing \$1.2 billion to train more than 300,000 employees for higher-skilled jobs as automation eliminates many existing roles.⁴²⁰ At big box retailer Walmart, training support ranges from workshops on basic retail and emotional skills for frontline staff to subsidies for tenured employees to study retail management at university.⁴²¹

Enabling organisation-wide agility will be critical to building the resilience needed in 2023 and beyond. Speed will be essential, underpinned

Exhibit 18:

Capabilities in supplier management, artificial intelligence and omnichannel customer experience are the areas in which fashion executives see the greatest skills gaps

Top five capability gaps, % of respondents



Source: McKinsey & Company Voice of Consumer Organisations Survey 2022

by cross-functional teamwork that eschews siloes, enabling fashion executives to allocate their talent to the strategic topics they believe will unlock growth. Top management must be prepared to change. Leadership teams must comprise executives with a diverse range of skills that reflect strategic priorities.

Above all, fashion leaders will need to prioritise talent and reconsider organisational evolution as the competitive advantage it has become. Human resource leaders will need to continue reconsidering how employees work together to ensure balance and efficiency around

remote or flexible work policies that keep people engaged. Companies defined by strong diversity and inclusion leaders and focused on transparency will help attract top talent and enable a business to evolve and become even more resilient in the years ahead.

MCKINSEY GLOBAL FASHION INDEX



Global Pressures Disrupt Widespread Rebound

Pent-up demand and a return to social settings began driving a strong recovery in 2022, raising expectations across the industry that the years of slowing growth and squeezed margins were coming to an end. But macroeconomic and other external factors could reverse the course of change yet again.

Key Insights

- The industry delivered strong top- and bottom-line growth in 2021, but the post-pandemic recovery is muted in a broader context.
- Value creators outnumbered value destroyers for the first time since 2014. More than 50 percent of MGFI companies contributed to the industry's positive economic profit, compared to 32 percent in 2020.
- Investors are becoming more cautious about how they value future earnings growth as the global slowdown is expected to diminish much of the growth momentum experienced in early 2022.
- The companies on this year's "Super Winners" list represented 85 percent of total industry EP in 2021, coming in well below the long-term average of 113 percent observed between 2010 and 2018.

Each year, the McKinsey Global Fashion Index (MGFI) charts the fashion industry's overall progress with an informative and holistic benchmark of sector performance. The analysis employs financial data from nearly 400 public companies to evaluate the sector's most important price segments, product categories and markets. The index primarily assesses economic profit (EP), a measure of value creation calculated as the difference between a company's currency-adjusted operating profit minus taxes and cost of capital. The metric also assesses value created over time, allowing the index to reflect how much each company invests to generate its results.

Since the onset of the Covid-19 pandemic in 2020, the MGFI has expanded its approach to

address the extreme fluctuations created by the health crisis. In this seventh edition, a similar approach was taken, evaluating the average EP over three years, from 2019 to 2021, while also looking at 2021 in isolation to make a distinction between pandemic recovery and incremental growth.

The exploration begins with the results of the 2019-2021 EP composition, showing how recent global turmoil has disrupted recoveries in different segments. The analysis also provides a review of the latest ranking of "Super Winners" — that is, the companies that led EP creation in the industry. By evaluating the performance of leading companies in the industry, the research identifies the drivers behind their success and explains how these forces have evolved. Finally, stock market valuations and

their implications for a company's success in the year ahead are examined.

Looking Back at 2021

After years of slowing growth followed by 2020's Covid-19 disruption, the fashion industry came roaring back in 2021.⁴²² EP grew significantly, reaching an MGFI level of 212 (with 2010 as the base year of 100), compared with negative 79 in 2020 and positive 80 in 2019.

Shoppers embraced opportunities to release pent-up demand, rushing online and to stores to compensate for months of curtailed shopping during the pandemic and to prepare for the return of pre-pandemic socialising. This burst of spending drove up revenue 21 percent year on year for the global sample.⁴²³

Profit grew even faster than revenue. The industry's average gross profit margin rose 2.1 percentage points to 52.8 percent, while EBITA margin increased 6 percentage points to 12.3 percent. Bottom-line growth was driven by a variety of factors. The boom in consumer demand was coupled with limited product supply — due to supply chain disruptions — which led to a higher share of full-price sales. In tandem, companies focused on controlling or cutting costs while pursuing operational discipline to avoid waste. Many also pulled back on store openings and other costly initiatives;⁴²⁴ invested capital was flat year on year and down 6 percent compared to 2019.⁴²⁵

However, the year-on-year comparisons only tell part of the story, particularly given 2020's pandemic-induced declines. When evaluated against pre-pandemic levels, the industry's trajectory in 2021 suggested a rebound, but it still fell short of past performance levels. Revenue for this global sample in 2021 was 3 percent higher than in 2018, lower than the average 5 percent annual growth rate that the industry experienced between 2010 and 2018. In contrast, revenue for the entire fashion industry grew around 3 percent less than in 2021 compared to 2018, reflecting how our

sample of listed companies outperform the market.

The industry's EP provides a similar narrative, with average EP between 2019 and 2021 coming in 18 percent lower than the long-term average between 2010 and 2018.

Overall figures from the past three years mask the stark differences in performance across categories. For example, luxury has been showing little sign of the stresses and strains evident in other parts of the industry and, in fact, produced record high results in some cases. Results at LVMH, Kering, Hermès and Richemont all suggested that there were more factors giving them a boost beyond the pent-up demand from the initial lockdown periods.⁴²⁶ Between 2019 and 2021, luxury's EP was 80 percent higher than it was between 2010 and 2018. LVMH delivered a particularly impressive performance: its EP grew by a factor of 13 times between 2020 and 2021.

Activewear companies — led by Nike, Adidas, Anta and Lululemon — also helped drive industry growth in 2021. The category's EP indexed to 2010 was 121 percent higher between 2019 and 2021 when compared to between 2010 and 2018.

Other categories suffered, however. Affordable luxury saw EP plummet 177 percent. Premium and mid-market companies also declined, while value and discount companies remained stable.

Starting Out Strong

The fashion industry entered 2022 in a position of strength, buoyed by continued high demand and stable profitability through the first half of the year. Top-line growth in the first half of 2022 for non-luxury fashion was 11 percent compared to the same period in 2021 and 14 percent compared to the same period in 2019.⁴²⁷ Luxury companies outperformed the rest of the industry once again. The category's revenue grew 27 percent in the first half of 2022, compared to the same period in 2021, and 43 percent compared to the same period in 2019.⁴²⁸ Revenue growth at traditional department

stores and malls was also higher than the industry average, as was the case for a number of luggage, formalwear and footwear brands.⁴²⁹

But conditions became more challenging mid-way through the year; replicating the first-half's strong performance would be tough given the effects of global geopolitical tensions, relentlessly high inflation and slumping consumer sentiment. Our McKinsey Fashion Growth Forecasts expect revenue in the second half of 2022 to be 5 percent to 7 percent lower for non-luxury fashion and 1 percent to 3 percent higher for luxury than in the second half of 2021.

While the fashion industry overall is expected to generate positive EP in 2022, companies should secure more capital if they want to sustain the first half's momentum. But fashion executives anticipate a need to reduce costs, with 37 percent saying they will prioritise cost improvement over growth in 2023, the highest percentage ever recorded since the The State of Fashion report began.⁴³⁰

Value Creation on the Rise

In recent years, the fashion industry's performance has followed more or less the same narrative: the most successful companies generate the vast majority of the industry's positive EP, while value destruction at the other end of the industry increased. The pattern reversed in 2021. In this year's analysis, companies appearing lower down the EP ranking — no longer weighed down by the extreme underperformers, which exited the industry during the pandemic — had a meaningful positive role to play in value creation. Value created by companies outside of the top 20 players in 2021 grew fourfold from 2020 and doubled compared to the average over 2010 to 2018.

While the EP created by the top 20 players increased 143 percent year on year in 2021, the relative contribution of the Super Winners to EP generation declined relative to previous years. Super Winners represented 85 percent of total

Economic profit (EP)

A measure of value creation defined as currency adjusted operating profit less adjusted taxes and capital charge

Currency adjustments

All MGFI data is adjusted to be analysed and expressed in USD current prices, based on the exchange rate of the latest available fiscal year (or other relevant time period, e.g. latest month for market capitalisations). For this year's edition, the average exchange rate of 2021 is used

Value creator

A company generating positive economic profit

Value destroyer

A company generating negative economic profit

Super Winners

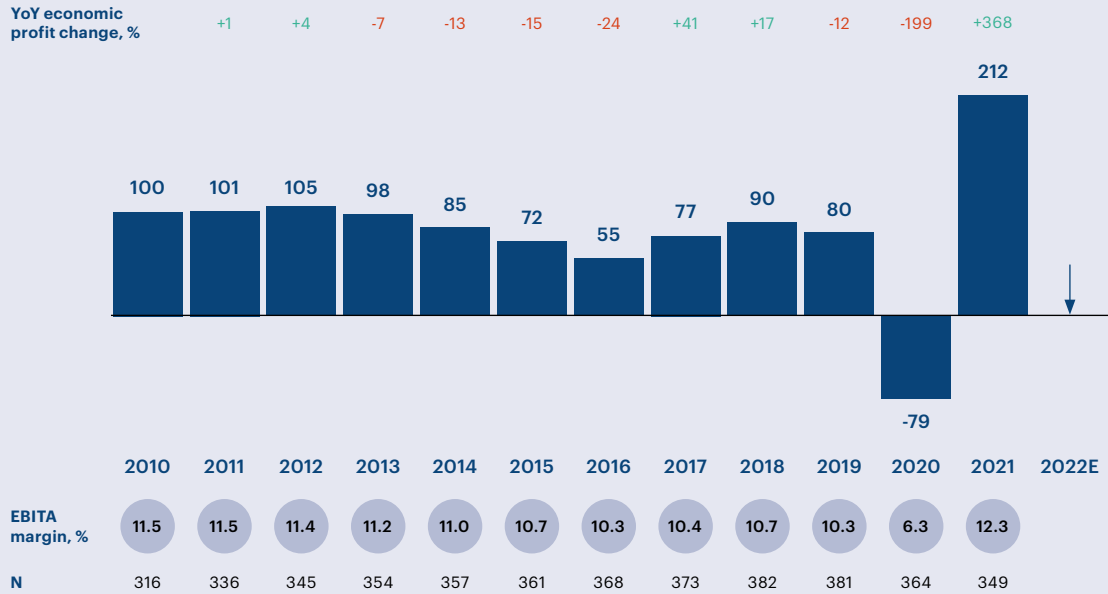
The top 20 companies ranked by economic profit over a given period; this year's list of Super Winners is based on years 2019 to 2021

industry EP in 2021, coming in well below the long-term average of 113 percent observed between 2010 and 2018.

The shift is due to a weeding out of value destroyers through bankruptcies, acquisitions or mergers — over each of the past three years

The industry's economic profit swings dramatically from negative to positive

Total economic profit (EP), index (2010=100)

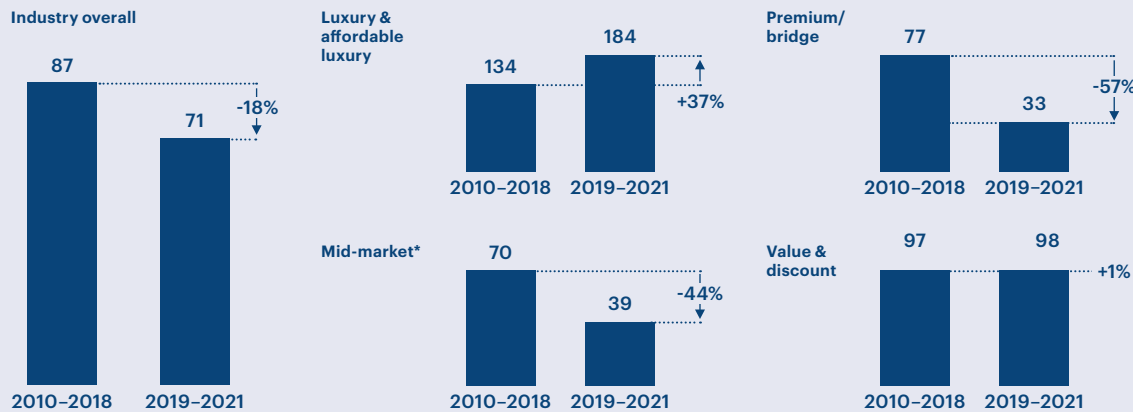


Source: McKinsey Global Fashion Index (MGFI)

Exhibit 20:

Luxury and discount increased economic profit over the past three years, while segments in the middle have struggled

Average economic profit, 2010-2018 and 2019-2021, index (2010=100)



Source: McKinsey Global Fashion Index (MGFI)

* The mid-market segment performance is driven by Inditex, comprising ~80 percent of 2019-2021 average EP. Excluding Inditex, the segment's average EP would be down 81 percent instead of 44 percent between 2010-2018 and 2019-2021.

What's behind the sharp rise in economic profit in 2021?

Much of the success in 2021 was contingent on the declines in 2020, with economic profit in 2021 "compensating" for 2020's decline into negative territory. The strong rebound is explained by a number of factors:

- **Pandemic recovery:** easing lockdowns and pandemic-related restrictions in most of the world, with a tourism rebound in Europe and the US, led to increased consumption and discretionary purchases, bolstering the industry's top line.
- **Macroeconomic forces:** continued government stimuli launched during the pandemic, such as payouts to households, led to increased spending power and demand. Improved market conditions and restored investor confidence, shown in record-high spikes of stock indices, also contributed to driving the industry's top line.
- **Consumer behaviour:** pent-up demand for discretionary goods was associated with consumers returning to social events, offices and travel as consumer confidence rose and shoppers splurged after two years of restrictions.
- **Cost and asset conservatism:** fashion companies made investments cautiously, if at all, and focused on operational efficiency — the resulting streamlined asset base and margin improvements benefitted economic profit.
- **Survival bias of sample:** given that the MGFI index comprises publicly listed companies only, the higher number of bankruptcies in 2020 compared to historic levels led to several underperforming companies captured in previous years to exit the sample for 2021. The removal of these underperformers therefore created a "healthier" sample for calculating economic profit. An analysis of a "steady sample" of companies that have been operating and reporting economic profit during the MGFI's complete timeline (2010-2021) shows the same results.

between 2 percent and 7 percent of companies left the sample, compared to nearly none in the pre-pandemic years, leaving a stronger set of companies. More than 50 percent of the MGFI companies contributed to the industry's value creation, compared to 32 percent in 2020, marking the highest level since 2013.

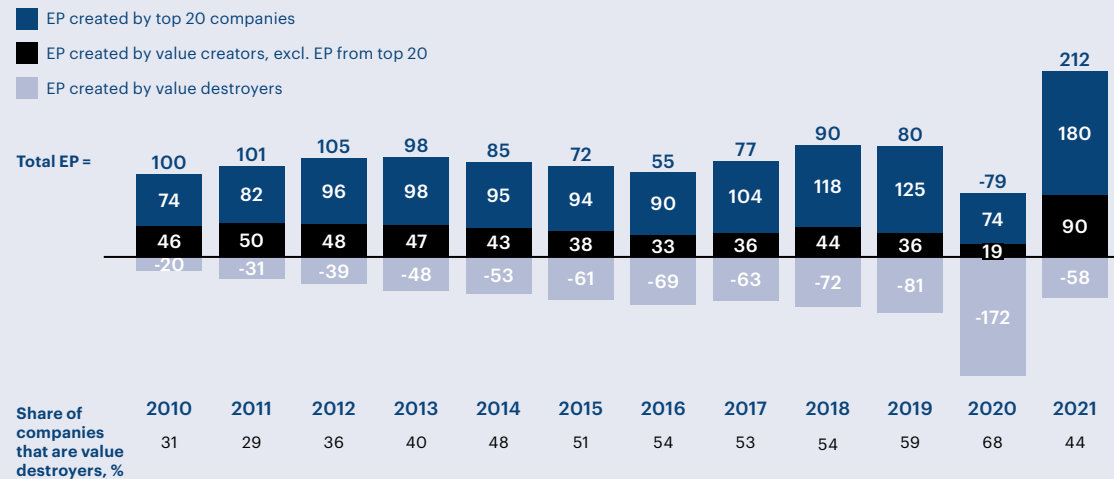
But these shifts may be temporary as the challenges in the second half of 2022 are likely to persist and disrupt the market in 2023, leading only the highest performers to contribute to industry EP, as in previous times.

Drivers of Value Creation in 2021

Along with the number of value creators outpacing value destroyers in 2021, the mid-market price segment, typically with a more challenging market position and margin profile, has benefitted from a strong industry rebound and spending recovery, creating value as a whole (in contrast to 2020) and being the category with the largest number of companies driving EP in 2021. A large share of value creation in the mid-market price segment is driven by Inditex, however, as it contributed close

The number of value creators in the industry rose in 2021, with the industry doubling 2010 EP levels

Total economic profit by top 20 players, value creators and value destroyers, index (2010=100)

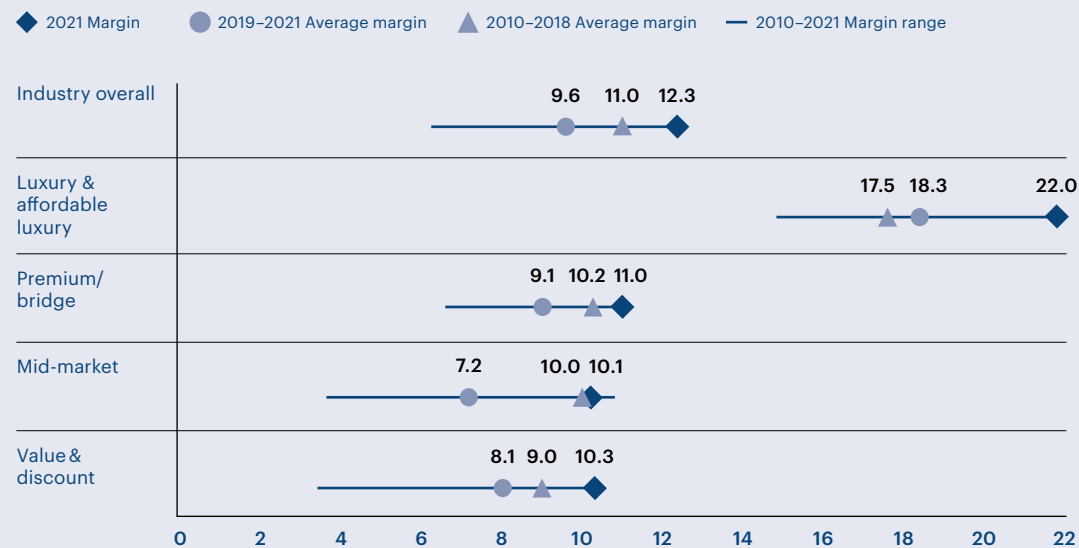


Source: McKinsey Global Fashion Index (MGFI)

Exhibit 22:

Margins have improved for all segments compared to before the pandemic

EBITA margin by value segment, 1 %



1 Segments adjusted for outliers that are structurally unprofitable due to business model

Source: McKinsey Global Fashion Index (MGFI)

MCKINSEY GLOBAL FASHION INDEX

to 80 percent of the segment's average EP during 2019-2021. Without Inditex, the mid-market segment performed similarly to the premium segment. Looking at profit and margin over the decade and in the last three years from our sample, however, the luxury segment is showing resilience and a growth trajectory.

Luxury in 2021 was propelled both by the spending of wealthy individuals who were relatively unaffected financially by the pandemic and who reallocated spending on travel and entertainment to fashion and accessories, as well as mid-income consumers who had increased their savings during the pandemic and wanted to indulge themselves. Luxury's EP has grown by a factor of 6 times to 7 times since 2020, and doubled since 2019. At 24 percent, its EBITA outpaced the rest of the fashion sector's 11 percent.

Though macroeconomic conditions in 2022 may undermine luxury's momentum, the category shows signs of resilience. LVMH reported 31 percent revenue growth in its fashion and leather goods division in the first nine months of 2022, while Hermès reported 24 percent year-on-year growth in the third quarter of 2022.^{431 432}

Sportswear's strong performance in 2021 is reflected in its EP, which grew nearly 60 percent year on year. Yet its relative contribution to value creation compared to other categories decreased, suggesting that sportswear's growth trajectory may be affected by the benefits of the pandemic boost that are fading and worsened economic conditions. In 2022, Adidas and others revised their outlooks downwards due to slowing demand and excess inventories.⁴³³

Value and discount companies also drove strong results in 2021, registering healthy revenue increases of 11 percent since 2018. Growth was driven by consumers seeking bargains amid economic uncertainty. The margins of both value and discount companies have not improved since before the pandemic, however, due to pressured cost bases and consumer pricing sensitivities.

Super Winners

In previous editions of the MGFI, the index highlighted a winner-takes-all environment led by a consistent group of Super Winners. This continued even as we adjusted our methodology to take into account the pandemic and calculated the average EP each company contributed over more than one year. The new approach helped to smooth distortions created by market disruptions over the two years, 2019 to 2020. This year, the methodology includes a 36-month period, evaluating combined EP for 2019, 2020 as well as 2021.

The latest group is a continuation of what was seen in recent years: despite large fluctuations in EP over the period in review, a similar group of top performers maintained their leading positions and proved their resilience. The five leading Super Winners, based on average EP over 2019, 2020 and 2021, in order of performance were Nike, LVMH, Inditex, Kering and Hermès. Nike maintained its top position despite setbacks in the later part of its fiscal year ended May 31, 2020 as the pandemic set in, while LVMH showed an impressive recovery and would have ranked highest if the index only evaluated 2021.

Dillard's and M&S were among the companies that delivered outstanding performances in 2021, demonstrating the strong recovery of department stores and general retailers, but failed to rank among the Super Winners for the three-year average period. In jewellery, Signet Jewelers was similarly successful in 2021. Richemont, the luxury brand that generates around 75 percent of its revenue from watches and jewellery, had a stellar 2021 after several years of negative EP, indicating strong market performance for jewellery companies. It jumped 281 positions to enter the Super Winners list and when evaluated by just 2021 alone, the company ranks as the eighth-highest EP generator.

Other new entrants to the Super Winners list include sporting goods retailers Dick's and Li Ning. VF Corporation, which also is in the

THE STATE OF LUXURY 2023



IN-DEPTH

Luxury's Next Digital Chapter

The luxury segment has ridden a wave of growth and prosperity, supported by a revolution in digital distribution. However, as economic conditions get tougher, luxury brands urgently need to consider the best way to move forward. Meanwhile, luxury e-tailers are under rising pressure to shape their business models to the new economic reality.

by Achim Berg, Anita Balchandani, Dale Kim, Andrea De Santis, Sarah André and Meera Singh

The performance of the luxury segment over recent times has been outstanding, with one season after another characterised by soaring demand and impressive bottom-line outcomes. Brands forged deep connections with their core constituencies and ignited their creativity. This, in turn, has spurred certain consumers to trade up and seek out ever-higher levels of indulgence. Meanwhile, the continuing expansion of digital engagement and e-commerce has created a turbocharged effect – fuelling demand, unlocking new insights and promoting competition.

However, as the global economic cycle turns, luxury brands are set to see rising pressure on their business models and channel strategies. Retailers, meanwhile, are already feeling the pinch, both in physical and online spaces. In response, luxury brands are searching for new engagement models, while e-tailers are exploring how to productively work with brands to engage with consumers, facilitate market access, and add value as the technology landscape evolves.

In tough times, a laser-sharp focus on

distribution can make the difference between success and failure – and even more so in a market increasingly led by e-commerce. One distribution model that has caught the attention of almost every brand is direct-to-consumer, but luxury brands in particular see a chance to capture wider margins by taking out the middleman, as well as realise benefits across economics, customer engagement and operations. With their strong brand equity and ultra-exclusivity, select luxury players, such as Hermès, have focused mainly on DTC distribution,⁴³⁶ which provides them with full control of brand positioning and storytelling. DTC has also allowed them to reinforce an even stronger sense of exclusivity: customers must come to the brand intentionally rather than coming across it randomly. And mastery over data has enabled brands to unlock personalised experiences – critical to stand out in a crowded e-commerce landscape – and forge deeper customer relationships.^{437 438}

Given its many potential benefits, a number of luxury brands see moving to 100 percent DTC

as an aspiration, both in terms of their physical outlets and digital channels. However, the pure DTC club remains highly exclusive. For now, only brands that command market-leading customer attention, and have deep pockets to maintain DTC customer relationships across channels, are ready to fully engage with the opportunity.⁴³⁹ (See DTC Reckoning on page 68.)

For many brands, wholesale partners are vital enablers of access to new customer segments.

Without the resources of an industry superstar, the majority of luxury brands are being realistic and opting for a gradualist and hybrid approach. For these companies, DTC remains an aspiration that for now should be considered alongside continuing engagement with multi-brand retailers. One reason is that multi-brand platforms bring a lot of value. Multi-brand retailers, for example, are virtuoso facilitators of customer engagement, and often bring their own powerful brand equity to the mix. Indeed, for many brands, wholesale partners are vital enablers of access to new customer segments. They also play an invaluable role in extending brand reach to niche areas of demand, as well as accelerating full-price sales when the opportunity allows and clearing inventory during slower periods.

Many brands plan to switch to more or all DTC are stymied by their e-commerce and digital marketing capabilities that have yet to scale. Furthermore, in the recent tough supply chain environment, most have suffered from delivery bottlenecks. And as economic headwinds become stronger, they face potential medium-term declines in volumes, which naturally in turn creates an aura of caution across go-it-alone plans, particularly as customer acquisition costs rise.

Depending on their market positioning and strategic orientation, individual luxury brands are

likely to identify with different aspects of these challenges and realities. However, the task for many, as they consider the impacts of rising interest rates and new customer behaviours, will be to align with the needs of their core markets as well as identify effective channel strategies to pursue growth and create efficiencies through the value chain.

Current State of Online Luxury Distribution

Individual e-tailer approaches often must sit within the parameters of specific business models. First-party retailers such as Net-A-Porter, Matches Fashion and SSense have typically focused more on online wholesale business models, though models are evolving.^{440 441} They have continued to apply their expertise to match brand inventory to customer demand, carefully managing curation, and optimising pricing and merchandising. By focusing on these core strengths, they have been able to continue to create significant upsides for brands, including cementing consumer trust in the retailer as a curator. This, in turn, has enabled them to drive conversion as well as augment brand positioning — supported by dedicated content and marketing.⁴⁴²

In a first-party environment, brands can face less inventory risk while seeing the positive impact of significant individual order volumes on cash flows and ongoing operations. On the other hand, brands are wary of the risks associated with retailers' oversight of variables such as inventory and markdowns. Mismanagement can lead to unpleasant impacts on brand equity. As a result, the total share of online first-party retailers is under threat from new distribution models and the ability of digital to let brands control their own operations.

The second dominant approach to luxury distribution is that offered by third-party online retailers, such as Farfetch, which also enables platform solutions for small and medium-sized retailers. Rather than taking ownership of products, these digital players provide brands with significant electronic real estate and large volumes

of customer traffic as well as valuable logistical support.⁴⁴³ In the most common approach, a brand retains inventory risk and controls consumer-facing variables such as assortment and pricing. This enables full control over key performance levers, including pricing, assortments and inventories, among other benefits.⁴⁴⁴

The ability to keep a hand on the tiller can lead to elevated price perception and shield against potential threats to brand equity. In addition, it can allow brands to more closely manage seasonal calendars and develop a perception of scarcity, a critical differentiator in the luxury space. Meanwhile, a higher level of control over curation, merchandising and content, means brands can manage and apply data more effectively — an increasingly valuable advantage in a world of artificial intelligence and machine learning — as well as leverage deep data mining to refine and enhance marketing campaigns.

The share of third-party models is likely to rise, reflecting the potential benefits to brands and retailers alike. Indeed, amid increased desire among brands for scarcity and exclusivity, they are conspicuously making efforts to reduce their exposure to first-party models. “We are stopping all online wholesale for our brands,” said Kering chief executive François-Henri Pinault, citing issues with discounting on the first-party channel.⁴⁴⁵ Prada is also among the brands reducing wholesale exposure, with co-chief executive Patrizio Bertelli saying, “We are still rationalising further [wholesale] ... and we think that this rationalisation will make the e-commerce activity and sales in our [directly operated stores] even more efficient.”⁴⁴⁶

As luxury brands renew their online distribution strategies, many first-party retailers are investing in developing hybrid offerings, taking the best of both models. For example, retailer Mytheresa — which formerly used a first-party model — has developed a “Curated Platform Model” for working with brands. Mytheresa will continue to manage curation and logistics, but brands will own their inventories and pay a concession

on sales.⁴⁴⁷ Meanwhile, Yoox Net-a-Porter has entered into drop-shipping arrangements with brands such as Prada. And after Farfetch recently acquired a 47.5 percent stake in YNAP, the shift from a traditional first-party to a hybrid first- and third-party model is expected to accelerate in the months ahead.

Cumulatively, these hybrid models are estimated to account for a small percent of pure-play online retailer GMV today. However, the share of the total is expected to rise as brands seek alternatives to traditional first party.⁴⁴⁸

A Vision for the Future

Given shifting consumer behaviours that favour digital engagement and the macroeconomic challenges facing brands, the mechanics of distribution are approaching a tipping point, which will affect both brands and retailers. With luxury brands focusing on DTC, along with work-in-progress digital and customer-centric business model transformation, five key trends are set to emerge over the coming period:

Growth of e-tailing, particularly the rise of third party, will be at the expense of physical wholesale and traditional retail: By 2025, luxury players will expand their share of the DTC market to 25 percent from between 15 percent and 20 percent.⁴⁴⁹

Online DTC and third-party e-tailers will drive growth: Online DTC and third party will account for the majority of growth (with online DTC GMV growing approximately 2.5 times and third-party GMV growing more than 3 times between 2021 and 2024).⁴⁵⁰

Third-party models will be the preferred choice for brands in the near term: Brands will increasingly favour third-party models over first party, in order to keep a tighter grip on brand positioning, achieve higher margins (between 5 and 10 percentage points), and steer traffic acquisition and data collection.⁴⁵¹

First-party models will be relevant

for brands that are at the highest risk during a potential economic slowdown: They will be anchored on their ability to take on inventory risk and help brands navigate economic headwinds.

Scale and consolidation will be required to take third-party models to maturity: Third party appears to offer a winning proposition but requires mature operators with greater reach, rather than currently, which is characterised by fragmentation across countries and brands. This will enable platforms to attract the attention of brands and consumers beyond that offered by products alone.

Luxury players, retailers and consumers will be impacted by these changes in varying degrees. However, the ability of businesses to reap the benefits is contingent on their flexibility to adjust to a shifting market while remaining aligned with consumer behaviours and a dynamic economic environment.

The potential impacts on luxury brands: In the current economic climate, only a few brands will have the capabilities to move decisively and immediately to a DTC model — and even the handful of brands that could make such a move will likely wait for economic conditions to brighten. A more likely scenario will be that brands transition from traditional wholesale and online first party into third party, while working to minimise any loss in GMV. This will enable them to capture some of the benefits of DTC while insulating themselves against excessive risk. The extent of recessionary headwinds will be a significant factor in dictating the speed of the shift.

Meanwhile, companies with lower brand awareness, weaker cash flows or inventory accumulations will likely take a more cautious approach, remaining on first-party platforms to support near-term growth.

In aggregate, the market will be polarised across brands forced to choose between first party as a means of mitigating unfavourable market conditions, and third party in order to establish greater control over customer data, inventory and pricing.

The potential impacts on retailers:

First-party players will be the most challenged in the near term but will weather the short-term impacts of a challenging macroeconomic environment. It is expected many will use this window to develop their third-party capabilities and create hybrid offerings. By 2024, we expect all major first-party players will develop third-person, concession-based alternatives alongside traditional wholesale models.

Retailers will bid to become hyper-distinctive in at least one area. This may be through the ability to facilitate discovery of up-and-coming brands and designers, curation and assortment, editorial content, the ability to optimise sell through and minimise waste, or best-in-class logistics. Some will also look to develop ancillary revenue streams, for example in data services or shareable logistics. First-party players that fail to differentiate will come under pressure, potentially leading to consolidation or market exit.

Based on the current trends and shifts observed, luxury goods distributed through third-party models are forecast to triple over the next two years.⁴⁵² Meanwhile, traditional omniretailers will leverage both models online. Already, some well-known retailers, such as Harrods, are partnering with digital natives to develop and manage their third-party solutions. Others may consider separating their online businesses, via spin-off or divestiture, to better optimise the technology focus needed to be a winning platform.

In the near term, winners of share will be e-tailers that are best positioned to capture the transfer of volumes from offline to online, and primarily those that successfully offer third-party models.

The potential impacts on consumers: As the competitive playing field resets, consumers will find they are offered fewer markdowns (especially after the current negative market momentum) across online platforms. Indeed, online platforms will no longer be seen as portals to the best prices. On the other hand, the shift to third-party models

and DTC should mean that consumers may find more streamlined assortments on their favourite first-party destinations. They will also overall see more refined and enhanced services online, alongside faster innovation and improved customer service. They may also start to use platforms to support lifestyle choices, for example in discovering new brands and ecosystems. Finally, they will benefit from speedier, transparent and more reliable deliveries.

Luxury brands face strategic choices over how they can best engage with their customers and stakeholders, as well as support their business priorities.

As the economic environment evolves and the impacts of the transition to more digital engagement continue to play out, luxury brands face strategic choices over how they can best engage with their customers and stakeholders, as well as support their business priorities. As leading brands seize the DTC opportunity, the majority face more nuanced decisions over the best way to play and the pace at which they should embrace new models. For many, the most prudent short-term strategy will be to adopt a hybrid approach, in which they begin to realise the control benefits that can be gleaned from third-party models, but hold onto the security offered by first-party approaches. For retailers, the task at hand will be to cater to these competing priorities, but also to make judgements around the probable pace of change and how that may play out. As they invest in their platforms, leading players will also explore possible routes to differentiation, both in respect of brand needs and consumer demand, where value-added services will become an increasingly important factor in willingness to engage and loyalty. As brand decision makers process these drivers to set budgets and make decisions, the likely winners will be those that distil their choices to reflect their specific segment needs,

while expertly optimising investment and efficiency to steer through the choppy waters ahead.

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GLOSSARY

3D printing

A process of making three-dimensional objects from a digital file, enabling production of complex shapes using less material than traditional manufacturing methods.

Affiliate marketing

A process where an affiliate partner, for example an online blog, publishes a link in its channel, promoting a product or service from a merchant, such as a retailer. The affiliate earns a commission for providing a specific result, typically a sale, to the merchant.

Artificial intelligence (AI)

Computer systems performing tasks by mimicking the problem-solving and decision-making capabilities of humans, often used to process large amounts of data for predictive purposes.

Athleisure

A hybrid fashion category that combines athletic with casual, everyday styles – for example jogging bottoms in athletic fabrics.

Baby Boomers

Demographic cohort born circa 1946-1964, following the “Silent Generation.”

Blockchain

A digital database containing encrypted information that can be simultaneously used and shared within a large, decentralised, publicly accessible network.

BoF-McKinsey State of Fashion Survey

A proprietary annual joint survey from *The Business of Fashion* and McKinsey polling international fashion executives and experts about their business sentiment, investment plans and industry trends. For the 2023 survey, 196 respondents took part between August and October 2022.

California Consumer Privacy Act

The state law aimed at enhancing data protection and privacy that went into effect on Jan. 1, 2020.

Circularity

An economic system aiming to eliminate waste and pollution, lengthen product lifecycles, promote the continual use of resources and minimise resource inputs.

Closed-loop recycling

A process whereby textile product waste (both post-production and post-consumer) is recycled into new textile products so that the materials remain in constant circulation (garment-to-garment).

Consumer sentiment

A measurement of how optimistic consumers feel about their finances, the economy and purchasing behaviour.

Cost of goods sold (COGS)

An income statement item reporting the total costs of creating a product or service that has been sold.

Covid-19

Coronavirus disease 2019 is an infectious disease caused by severe acute respiratory syndrome coronavirus 2 and was classified as a pandemic by the World Health Organization on March 11, 2020.

Direct-to-fabric (DTF) printing

A process in which printing is done on a roll of fabric.

Direct-to-garment (DTG) printing

A process in which printing is done directly on the fabric that is already cut and sewn into a garment.

Direct-to-consumer (DTC)

Selling products directly to the end consumer instead of through third-party retailers, wholesalers and so on.

Discretionary goods

Goods that consumers deem are not essential, such as travel, dining out or entertainment, as well as fashion and beauty items, including apparel, footwear and accessories.

EBITA

An income statement item that is arrived at by deducting amortisation from earnings before interest and taxes, which is an alternative measure of income a company makes from its core operations.

EBITA margin

A measurement of a company's EBITA as a percentage of its total revenue.

Economic profit

A measure defined as currency-adjusted Net Operating Profit Less Adjusted Taxes (NOPLAT) minus capital charge (Weighted Average Cost of Capital, or WACC, multiplied by invested capital).

Environmental, social and corporate governance (ESG) investing

An investment strategy that screens potential investments based on environmental, social and corporate governance criteria, as well as financial performance.

First-party (1P) data

Data collected from customers via a brand or retailer's own channels (such as a website, app or in store), enabling businesses to use data in a privacy-compliant and cost-effective way.

Fiscal response

The use of government spending and taxation (e.g. taxes or tax cuts) to influence the economy.

Freight

Goods transported from place to place by land, sea or air.

G20

The group of 20 brings together the world's developed and emerging economies that form more than 80 percent of global GDP. G20 members include Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, Mexico, Russia, South Africa, Saudi Arabia, South Korea, Turkey, the UK, the US and the EU. (Spain is also invited as a permanent guest.)

General Data Protection Regulation (GDPR)

The EU's law on data protection and privacy, implemented in 2018.

Generation-Z (Gen-Z)

The demographic cohort born circa 1996–2012, following the Millennial generation.

Giga-scaling

The process of scaling to a very high magnitude.

Green hydrogen

With significantly lower carbon emissions than grey hydrogen, it is generated by renewable energy or from low-carbon power, by using clean electricity from surplus renewable energy sources, such as solar or wind power, to electrolyse water.

Greenhouse gas emissions

Greenhouse gases vented to the earth's atmosphere as a result of human activity; includes carbon dioxide and equivalents that can cause climate change.

Greenwashing

Communication that suggests a company or its products are environmentally friendly in a way that is misleading, exaggerated or not reflected in overall business practices.

Grey hydrogen

As the most common type of hydrogen production, it is created from natural gas, or methane, using steam methane reformation without capturing the greenhouse gases made in the process.

Gross domestic profit (GDP)

As a measure of economic health, it is total monetary or market value of all the finished goods and services produced within a country's borders in a specific time period.

Gross merchandise value (GMV)

Also known as gross merchandise volume, this metric is the total value of sales generated or facilitated by a company, including through customer-to-customer or peer-to-peer platforms. GMV is calculated before accrued expenses (such as costs associated with advertising and marketing, delivery costs, discounts and returns) are deducted.

Hybrid working

A flexible way for employees to split their working hours between an office and their homes.

In-vitro cotton

Cotton produced outside of the natural biological cotton – in-vitro in a lab-type of environment. This cotton uses significantly less water and land than traditional cotton.

McKinsey Global Fashion Index (MGFI)

A proprietary and copyrighted McKinsey tool that provides a global and holistic industry benchmark for the entire fashion industry. The MGFI was first created for *The State of Fashion 2017* to track industry performance through three key variables: sales, operating profit and economic profit. MGFI comprises an extensive list of public companies spanning market segments, product categories and geographies. The analysis of public companies is built with data from McKinsey Corporate Performance Analytics Tool (McKinsey CPAT).

Mergers & acquisitions (M&A)

The combining of two or more companies through various types of financial transactions, including mergers, acquisitions, consolidations, tender offers or the purchase of assets.

Metaverse

The envisioned future iteration of the internet that is made up of 3D virtual spaces linked within a perceived virtual universe. In a broader sense, it often refers to not just virtual worlds, but the full spectrum of virtual reality, augmented reality and the internet.

Millennials

The demographic cohort born circa 1982–1995, also referred to as Generation-Y (based on Generation-X, the generation that

preceded them).

Nearshoring

The service of a third-party providing a service from a geographic location that is relatively close to a company's markets.

Net promoter score (NPS)

A measure of customer experience used to evaluate and predict business growth. The metric is calculated by customers answering a question using a 0-10 scale: How likely is it that you would recommend [brand/product] to a friend or colleague?

Non-fungible token (NFT)

An entry on a blockchain recording a unique digital asset (e.g. images or videos) and its owner, enabling the documentation of any sale or transfer of the asset. Often associated with the metaverse, NFTs are a building-block technology that will allow for true ownership of digital goods.

Off-price channel

A trading format based on discount pricing. Off-price retailers or retailers operating off-price channels are typically independent of manufacturers and buy large volumes of branded goods directly from them. The model relies on the purchase of over-produced, or excess, branded goods at a lower price.

On-demand manufacturing

A manufacturing system in which products are only manufactured when needed and in quantities required, in contrast to traditional manufacturing that manufactures products in large quantities which are stored in facilities until they are sold, distributed and delivered.

Price segment

The company segmentation based on a Sales Price Index, which provides a range of prices for a standard basket of products within each segment and the company's home market. The companies in the McKinsey Global Fashion Index and the BoF-McKinsey State of Fashion Survey are categorised in six segments, which are based on a price index across a wide basket of goods and geographies. The segments comprise (from lowest to highest price segment): discount, value, mid-market, premium/bridge, affordable luxury, and luxury.

Radio-frequency identification (RFID)

A wireless system of tags that uses radio waves to identify and track an object, e.g. when tracking items along a supply chain.

Regenerated fibre

Fibre created from pre-existing fibres whose cellulose areas are dissolved in chemicals and rebuilt into new fibres by viscose method.

Regenerative materials

Materials that are bio-based, reusable, non-toxic and non-critical. They are organic and can be made from by-products of agricultural processes, or can be grown and harvested responsibly.

Repatriation

The process of sending money back to one's home country; in relation to shopping, this refers to when a consumer spends money domestically rather than abroad.

Retail media networks

A network in which a retailer gives advertisers access to its first-party customer data and channels, such as the retailer's website or app. This allows brands to reach in-market consumers when they are in a purchasing mindset.

Retention

Keeping employees at a business through a number of measures and incentives to reduce staff turnover.

Selling, general & administrative expenses (SG&A)

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

Social media growth hacking

An activity that seeks to reach a goal as fast as possible; for example, higher brand recognition, followers or sales, by experimenting with multiple tactics and reviewing smaller sets of data and iterating. This could mean sharing on different social media networks and reviewing clickthrough rates to understand how traffic or sales are improving.

Super Winners

The top 20 fashion players by economic profit (based on average economic profit 2019-2021) according to *The State of Fashion*.

Sustainability

Within a business context, sustainability refers to businesses making decisions in terms of environmental, social, human and corporate governance impact for the long term and relates to how a company's products and services contribute to sustainable development.

The Great Resignation

A term describing the elevated rate at which US workers resigned from their jobs that began in the spring of 2021 amid strong labour demand and low unemployment rates, as vaccinations eased the severity of the Covid-19 pandemic, with similar developments in other parts of the world. It was likely a result of pent-up demand from workers who deferred decisions to quit early in the pandemic.

Third-party (3P) data

Data purchased from external sources such as aggregators that are not the original collectors of the data. The third parties purchase data from other sources across the web to aggregate, segment and resell it.

Traceability

The ability to identify and monitor the history, distribution, location and application of materials, parts and finished goods to understand the understand the sustainability practices relating to a product.

Value creator

A company that creates value generates positive economic profit – that is, its operating profit exceeds its dollar cost of capital (profit above 0). See above for the definition of economic profit.

Value destroyer

A company that destroys value generates negative economic profit – that is, its dollar cost of capital exceeds its operating profit (profit below 0). See above for the definition of economic profit.

Vertical integration

A corporate strategy that occurs when one company acquires a producer, vendor, supplier, distributor or other related company along the same value chain.

Virtual sampling

A digitised, three-dimensional product development process, enabling designers to create virtual samples simulating movement, stretch and use.

Web3

The next phase of the internet using a decentralised, peer-to-peer model powered by blockchain technology on which apps and platforms would be built.

INFOGRAPHICS

1. Global Fragility

Source: BoF-McKinsey State of Fashion 2023 Survey

2. Regional Realities

Source: BoF-McKinsey State of Fashion 2023 Survey

3. Two-Track Spending

Source: McKinsey & Company US Consumer Pulse Survey, July 7-10 2022, n = 4,009 sampled and weighted to match the US general population 18+ years

4. Fluid Fashion

Source: Klarna Insights survey, May/August 2022, in cooperation with Dynata. Survey conducted across 11 countries (US, UK, Australia, Sweden, Norway, Finland, Denmark, Italy, France, Germany and Poland), (N=8,114: consumers aged 18 to 75)

5. Formalwear Reinvented

Source: BoF-McKinsey State of Fashion 2023 Survey

6. DTC Reckoning

Source: BoF-McKinsey State of Fashion 2023 Survey

7. Tackling Greenwashing

Source: BoF-McKinsey State of Fashion 2023 Survey

8. Future-Proofing Manufacturing

Source: McKinsey Apparel CPO Survey 2021

9. Digital Marketing Reloaded

Source: Retail Media Network Survey 2022 (N=188)

10. Organisation Overhaul

Source: Franck Laizet, Miriam Lobis, Patrick Simon, Raphael Speich, "Crafting a fit-for-future retail operating model", McKinsey & Company, May 26, 2021

EXHIBITS

Exhibit 1: Industry Outlook

Source: McKinsey Fashion Forecasts; McKinsey analysis; expert interviews

Exhibit 2: Industry Outlook

Source: McKinsey Fashion Forecasts; McKinsey analysis; expert interviews

Exhibit 3: Industry Outlook

Source: BoF-McKinsey State of Fashion 2023 Survey, BoF-McKinsey State of Fashion 2022 Survey

Exhibit 4: Industry Outlook

Source: BoF-McKinsey State of Fashion 2023 Survey

Exhibit 5: Global Fragility

Source: BoF-McKinsey State of Fashion 2023 Survey

Exhibit 6: Managing Inflation for Growth

Source: McKinsey & Company US Consumer Pulse Survey

Exhibit 7: Managing Inflation for Growth

Source: BLS

Exhibit 8: Regional Realities

Source: BoF-McKinsey State of Fashion 2023 Survey

Exhibit 9: Two-Track Spending

Source: McKinsey analysis based on Euromonitor and McKinsey Europe Consumer Pulse Surveys

Exhibit 10: Fluid Fashion

Source: Klarna Insights survey in cooperation with Dynata

Exhibit 11: Formalwear Reinvented

Source: StyleSage

Exhibit 12: DTC Reckoning

Source: Yahoo Finance and CNBC

Exhibit 13: Tackling Greenwashing

Source: BoF-McKinsey State of Fashion 2023 Survey

Exhibit 14: A New Approach to Scaling Innovative Materials

Source: McKinsey and Global Fashion Agenda, Fashion on Climate

Exhibit 15: A New Approach to Scaling Innovative Materials

Source: McKinsey & Company

Exhibit 16: Future-Proofing Manufacturing

Source: BoF-McKinsey State of Fashion 2023 Survey

Exhibit 17: Digital Marketing Reloaded

Source: Business Insider

Exhibit 18: Organisation Overhaul

Source: McKinsey & Company Voice of Consumer Organisations Survey 2022

Exhibit 19: MGFI

Source: McKinsey Global Fashion Index (MGFI)

Exhibit 20: MGFI

Source: McKinsey Global Fashion Index (MGFI)

Exhibit 21: MGFI

Source: McKinsey Global Fashion Index (MGFI)

Exhibit 22: MGFI

Source: McKinsey Global Fashion Index (MGFI)

Exhibit 23: MGFI

Source: McKinsey Global Fashion Index (MGFI)

END NOTES

1 BoF-McKinsey State of Fashion 2023 Survey

2 BoF-McKinsey State of Fashion 2023 Survey

3 BoF-McKinsey State of Fashion 2023 Survey

4 BoF-McKinsey State of Fashion 2023 Survey

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