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Succeeding in tomorrow's global fashion market

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The dynamics of the apparel industry are changing dramatically. To succeed amid the shifting tides, companies need to build up competence in four disciplines.

Few industries require companies to stay as nimble and on their toes as the global apparel business. At a baseline level, there is the fast-moving nature of fashion, which requires companies to jump on trends right away, never taking the fast follower approach. That alone gives the apparel business a unique set of challenges.

Today, however, additional dynamics are stirring the pot. Apparel consumers not only want to see a level of freshness in their products, but also in the entire shopping experience. As is the case across many industries, shoppers increasingly want brands to speak to them with the same level of relevance, whether they are on an iPad or browsing in a store.

The apparel business also hosts some of the world's most rapidly growing companies. A number of smaller entrants, both online and offline, are growing at the speed of light, quickly bringing their banner to global scale. For established players, this can feel like looking in the rear view mirror and watching a car approach at 400mph. The German-based online retailer Zalando, for instance, has expanded its convenient, no-cost shipping, no-hassle returns brand of ecommerce to 15 countries in just six years. And Under Armour, the U.S. sportswear and footwear company, has tripled its revenue in the past five years.

All of these challenges come with great opportunities. The size of the global apparel business is growing and is expected to generate double digit growth between now and 2020. Much of this growth is coming from developing markets, notably from the exploding buying power among Asian consumers, who are migrating into the middle class and starting to view clothes as an extension and expression of their new lifestyle. These consumers are also increasingly travelling

– and shopping – abroad. By 2020, foreign spending of Asian-Pacific residents outside of their home countries will triple, totaling $600 billion. In the luxury goods segment, 75 percent of all sales will be from Chinese consumers, with more than half of that being spent outside of China (Exhibit 1).

Exhibit 1:
A center of gravity shift is happening in the women's apparel market

These are just some of the ways in which the world will look very different for apparel companies in 2020 than it does today. What can fashion companies do today to be among tomorrow's winners? In this article, we discuss the primary ways in which the world is changing and how these shifts will have a significant impact on the way apparel brands and retailers do business. The McKinsey Trend Barometer – based on expert interviews, client studies, and industry reports – identifies seven global trends that point the way toward sustainable value creation.

The signposts: seven trends

Moving targets. Target groups change continuously, but within just a few years, these shifts will spawn great diversity, the likes of which the world has never known. First, the global population is aging rapidly: In the U.S., for instance, the segment of consumers over 55 is growing faster than any other – both in terms of their share of the total population and their expenditures for clothing. Second, the global economic base of power is shifting from north to south and from west to east. Fifteen of the 20 cities in which apparel sales are growing the quickest lie outside established Western markets, in places like Chongqing and Guangzhou. In China, one of the most important trends to watch is the increased purchasing power of men, as more Chinese men become interested in clothing and fashion. Third, increasing migration is giving rise to new customer profiles. Thus, the buying power of Hispanic Americans in the U.S. will triple by 2020.

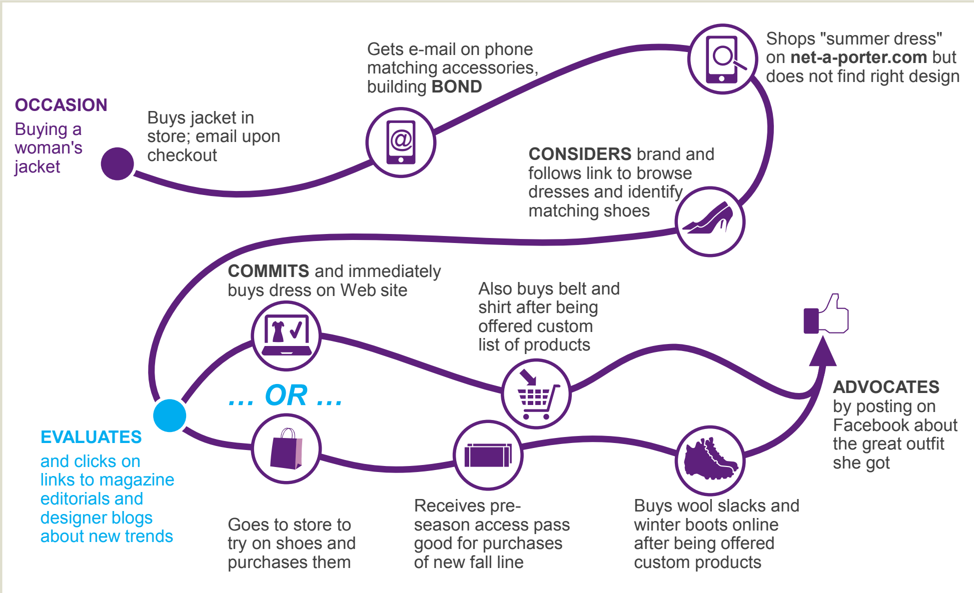
Sustainability. Around the globe, fashion consumers are becoming more environmentally conscious. They expect ecologically unobjectionable fabrics, a conservation-minded use of resources, reduced emission of pollutants, greater social commitment, and fair treatment of employees in production facilities. In many countries, legislators are requiring companies to create more sustainable products, such as by prohibiting certain harmful dyestuffs. Yet unfortunately, only the fewest customers are willing to pay more for these greener products. One pioneer of this trend is Stella McCartney, who forgoes using leather in her shoes and handbags. A clear commitment to sustainability is also considered good style in the industry, with online fashion retailers like Yoox now providing sustainability reports.

This has vast implications for apparel companies across the whole value chain.

Core functions need to be adapted to make and market more sustainable products. Environmentally-friendly products require the right commodities like organic cotton, which is in scarce supply, or a complete overhaul of the manufacturing processes to reduce the huge amount of water typically used for apparel. Ethical products require appropriate working conditions and a fair share of profits across the supply chain. In short, it entails a complete rethinking of functions and processes.

Digitization. Young fashion customers readily use a spectrum of digital platforms to get information on trends, exchange experiences, or compare prices. Within these customer journeys, social media plays a key role. Up to 35 percent of consumers indicate that they rely on recommendations from social networks. This is why adidas' fast fashion brand NEO, for instance, has equipped several of its European concept stores with interactive mirrors. These enable customers to take a picture while trying something on and then to post it to networks like Facebook for instant feedback from their friends before purchasing (Exhibit 2).

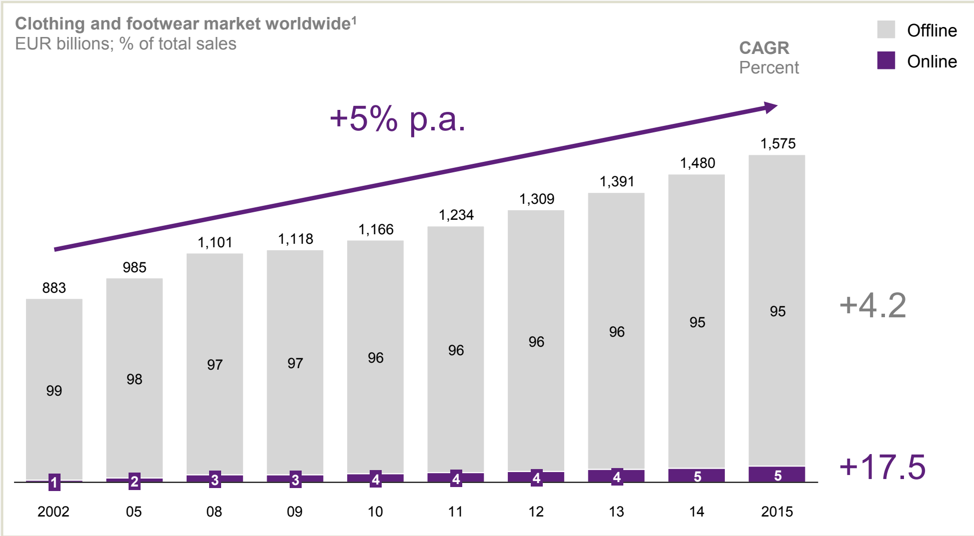
Exhibit 2:
The consumer decision journey for a women's jacket



Channel convergence. Digital channels no longer only serve to provide pre-purchase information; they have become standalone transaction platforms. Primarily thanks to mobile devices, global online clothing and shoe retailing is growing at a rate three times that of the market overall (Exhibit 3). Independent of channel and device, fashion consumers expect a seamless shopping experience, which presents big challenges for retailers and their partners, requiring them to fuse links between these channels. One forerunner in integration is Burberry, which has equipped all of its store associates with iPads that help make a customer's store experience closer to that of online. Associates can order goods not available in the store – in the London flagship, 10 percent of orders are placed this way. The iPads also add a high level of convenience and personalization – associates know exactly what their customers want by understanding what they did online, what's in their basket, what they've said about Burberry on Facebook and Twitter, and how many times they've called customer service.

Deluge of data. Manufacturers, retailers, and service providers are compiling more and more customer data at all kinds of new touch points – from user accounts to social networks. Based on this data, sophisticated algorithms can calculate the time, type, and scope of the customer's next purchase with high precision and probability. This can yield diverse ways of personalizing advertising, new customer interactions, and product offerings. But prior to this comes the challenge of processing huge volumes of data in real time. Apparel brands and retailers need to first identify which data is most relevant and

Exhibit 3:
Euromonitor: Global apparel and footwear market growing 5%, but online channels are growing 3 - 4 times faster



1 Euromonitor

then have the capabilities and organizational structure in place to use it, something that inevitably requires an understanding of the relevance of IT and big data at the corporate level. One leading textiles retailer in South Africa was able to boost its operating margin by 1.5 percentage points thanks to the help of big data. The key lever in doing so was more targeted pricing based on customer and competitor data.

Urbanization. Since 2008, half the world's population has been living in cities. By 2020, a quarter of global wealth will be concentrated in just 60 mega-cities, some of which will be larger than countries. Already today, a large share of the fastest-growing cities lies outside Europe and North America, primarily in China and India. The future impact of these trends will be even more dramatic in the apparel business than in most others. Emerging markets in Asia and South America currently account for roughly one-third of global revenues for women's apparel. Over the coming 20 years, this share will grow to over half.

Hybrid growth. Segment polarization has been a hot topic in recent discussions among apparel experts. The luxury segment in the UK, for instance, is booming at double-digit growth rates and the low-price value segment is growing at around 8 percent – still double the rate for the market overall – thanks in large part to the success of fast fashion. Yet the hotly contested middle market also has winners, particularly in affordable luxury, which resides somewhere between the mass and luxury segments. This is where labels like Karen Millen, Ted Baker, and Hugo Boss can be found, and also names like Maje, Sandro, and Claudie Pierlot. Such brands offer high product quality at prices that are significantly lower than comparable items in the luxury segment. Other fashion companies, such as Scotch & Soda, address the desire many customers have for affordable variety. This Dutch label was revived in 2001 by three up-and-coming designers and now generates revenues in the triple-digit millions.

Against the backdrop of these trends, global fashion companies will need to develop new patterns for success to grow further, remain successful, or regain lost ground. In particular, there are four disciplines in which companies will need to find new answers to old questions.

Success pattern one: Global-local brand management

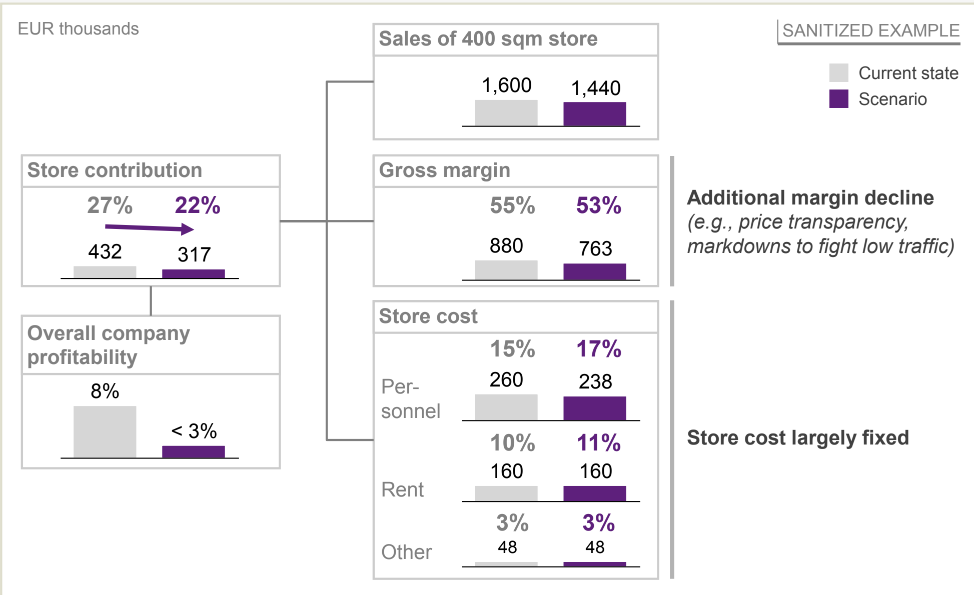
Large fashion chains such as H&M and Zara rely on an internationally uniform brand identity. They effectively export their Scandinavian or Mediterranean lifestyle around the world. This works well as long as customers in the growth countries are primarily oriented toward Western role models – at least in terms of fashion. At the same time, however, consumers in the new markets are gaining self-confidence and demanding local brands and local products. Like it or not, global players will thus need to prepare for much more agile local competitors.

But can a global brand really live up to the needs of diverse cultures from Latin America to Eastern Europe all the way to Asia without putting its identity on the line? Even within one country there are often huge differences in buying power and customer preferences. This is the reason that Gucci, for example, decided to align its offering in China to the various urban classes. Instead of a one-size-fits-all brick and mortar expansion, Gucci takes a tiered approach to product assortment. In secondary cities with less affluent customers, comparatively less expensive leather goods and accessories dominate the shops, while in Beijing and Shanghai the emphasis is on exclusive apparel. Zara pursues a similar strategy in the mass market. The company focuses on uniform window display design around the world, while allowing for the selective regional adaptation of those displays.

Success pattern two: New shopping experience

There is double economic pressure on stores these days. On one hand, profit margins and sales per square meter are decreasing, thanks to larger and larger stores, declining traffic, and competition from new formats and competitors – particularly on the Internet. For many companies this is not a description of the future but a current reality (Exhibit 4).

Exhibit 4:
How the double store squeeze can harm the economics of a typical 400 sqm apparel store



At the same time, shopper expectations are growing due to the fact that online sites are 24/7, have most SKUs in stock, feature intuitive site navigation, often have no-questions-asked returns policies, and offer reduced prices and shopping excitement features like daily deals and auctions. Imagine all that and apply it to a store. Could you ever make money doing it? Probably not. The Internet is not only growing its share of the market against offline retail and shrinking in-store traffic due to online fulfillment, it is also raising expectations – both those of consumers and of the brands featured within department stores. When customers do find their way into brick-and-mortar stores, they are armed with online research and are more demanding than ever. Thus, established brands and department store retailers should take a critical look at the shopping experience they offer and modernize it. In other words, a holistic rethinking of what a store is. This starts with retailers asking themselves the following questions in three critical areas.

Store function. For each store, it is important to ask: Is the primary role of this store to drive sales and deliver commercial success, or to serve as a brand ambassador delivering a unique consumer experience and supporting online sales? Retailers will need to reevaluate store locations and sizes, optimize store density, design stores for a lower investment and operational cost, and potentially renegotiate leases.

Organization. These days, almost no retailer will be able to get around lean operations. How can operational processes like warehousing and supply chain management be leveraged to enhance the attractiveness and efficiency of the store's business?

Store design. How can the use of existing floor space be changed to excite even the most spoiled customers and to balance out declining floor space productivity?

There are a few ways we're seeing companies deal with the double store squeeze. The UK department store John Lewis, for example, has been experimenting with significantly smaller stores in which customers can place online orders. "We can now consider opening shops in areas that were not always thought feasible for a traditional John Lewis building," says Andy Street, managing director of John Lewis.[1] Nordstrom sublets a portion of its space to originally pure Internet retailers to cover their demands for physical showrooms and to simultaneously increase its own contribution margin.

Success pattern three: Multichannel strategy

The purchase process is no longer a linear sequence and hasn't been for quite some time. Online retailing is increasingly melding with store business. Traditional retailers will need to adapt to new shopping behaviors without stretching their brands too thin or sacrificing their business models to the growing complexities of logistics.

Presence. Would a consistent yet logistically separate presence in different channels suffice, along with the opportunity to place online orders in the store?

Service. Do fashion customers expect to be able to pick up, try on, and return their online orders in the store?

Consistency. How can a uniform brand and shopping experience be ensured across stores, retail partners, and different channels and devices?

Numerous fashion chains have set up terminals for online orders in their stores. Leading brands have adjusted their business systems completely to the requirements of the multichannel world, allowing customers to pick up their online orders in a store of their choice as quickly as within one hour of purchasing (Exhibit 5).

Success pattern four: Megacity management

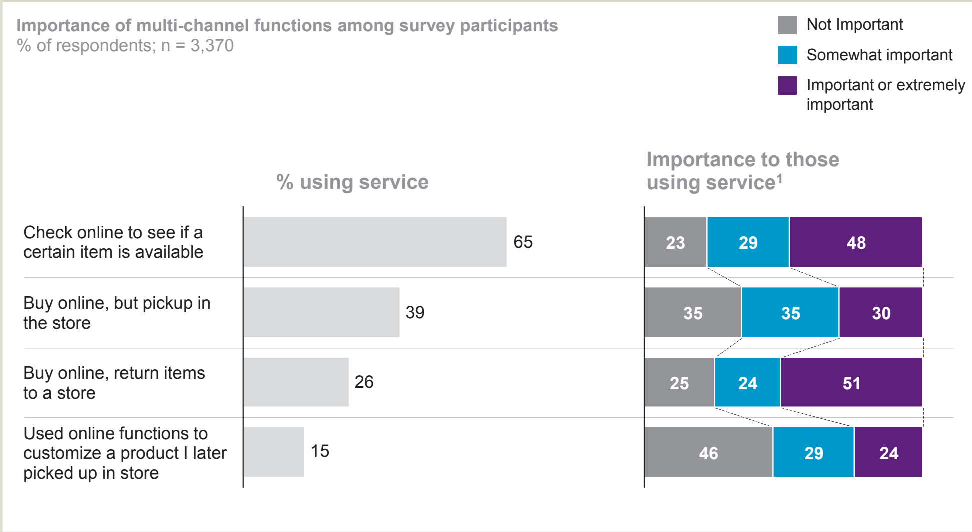
Today, there are 25 megacities around the world with populations topping 10 million. In 2020, there will be 60. Several of these are already larger markets for the fashion industry than some entire countries. China's fourth-largest city Tianjin has, for example, 13 million residents and already generates as much revenue from apparel as all of Sweden – and it's growing faster than New York or Tokyo. In 2025, Tianjin will be among the world's 20 largest apparel markets, larger than even Rio de Janeiro. The future growth of the entire fashion market will be concentrated in a few metropolises in Asia and South America (Exhibit 6).

For the fashion industry, this development gives rise to completely new structural questions. Will the country's market continue to be the organization's smallest cell? Or will selected megacities soon need their own P&L responsibility and freedom in designing sales, product assortment, price levels, communication, and staff development?

1 "John Lewis thinks small to beat recession with compact stores in well-heeled towns," *The Guardian*, October 14, 2012

Exhibit 5:

Customers are beginning to demand multi-channel functionality



1 Answer to question: "How important is it to you that stores you shop at offer the following types of services?"

Exhibit 6:

Top 10 apparel growth cities between now and 2025

There are also questions concerning corporate leadership. Will the next CEO of a global fashion group come from one of the large country corporations? Or will these business leaders soon be competing with tomorrow's megacity managers for the top position?

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The global fashion market will continue to grow, but not all current participants will share in this growth. Fashion rewards the competent. Companies that prove themselves in the areas of global brand management, shopping experience, multichannel strategy, and megacity management will have the best outlook for success.

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