

Retail Practice

Uncovering the state of fashion

With the global economy cooling and concerns about sustainability rising, the mood among fashion-industry executives is far from exuberant.



In this episode of the *McKinsey Podcast*, Simon London speaks with Business of Fashion founder, CEO, and editor-in-chief Imran Amed and McKinsey partner Achim Berg about the current state of the fashion industry. An edited transcript of their conversation follows.

Simon London: Hello, and welcome to this episode of the McKinsey Podcast, with me, Simon London. Today, we are going to be putting on our favorite outfits, getting all dressed up, and talking about the state of fashion—who's making money, who's not, the rise of fashion tech, and the common challenges posed by sustainability.

To discuss the state of fashion, I spoke with McKinsey partner Achim Berg, who's based in Frankfurt, and Imran Amed, who is the London-based founder, CEO, and editor-in-chief of the media company Business of Fashion. We started by discussing the latest State of Fashion report, which is published jointly by Business of Fashion and McKinsey.

I should point out that we recorded this episode immediately before the Coronavirus outbreak in China. While we do talk about the state of fashion in Asia, we don't address coronavirus directly in this episode.

So Imran and Achim, welcome to the podcast, and thank you for being here.

Imran Amed: Thank you for having us.

Achim Berg: Thanks a lot.

Simon London: So Imran, why don't you start by giving us the highlights from the latest report. I know we survey a large number of fashion executives to take the temperature of the industry. So are they cheerful? Are they miserable? What are they saying about the outlook?

Imran Amed: With an economic environment that's getting more and more uncertain, there is more and more uncertainty in the fashion industry.

You know, for several years now, executives have been using words like “challenging” and “changing” when we've talked to them for this annual survey. But this year, the percentage of executives who were positive about the growth to come next year was at its lowest level ever. It was down to 9 percent, compared to 49 percent last year. So there has been a radical important shift in mindset and outlook.

In the big emerging markets, particularly China, that the luxury and fashion industries have relied upon for the last few years to continue to drive growth, the growth seems to be slowing. And then there's political uncertainty, geopolitical tensions, trade wars, and all sorts of other unknown elements that are lurking in the background. And I think people are just very cautious at the moment. So that's kind of how I'd sum it up. Achim, what you would add?

Achim Berg: I think that is a very good description of what we've seen over the last couple of years. We obviously have also seen an intensifying competition. All the digital players have entered the playing field and have had clear impact on the more incumbent players. And we generally see that there is increased polarization happening in the industry.

We see that the top performers got a bigger and bigger share of the profit pool. By now, only 45 percent of all the players that we survey in our McKinsey Global Fashion Index are value contributing, while 55 percent are value destroying. And, in general, it's getting more polarized.

It is more difficult to make a profit, particularly if you are a midsize, midmarket player, because you have to deal with the omnichannel world, with digitization, and with sustainability. So there are a lot of demands on what you need to do. And there is a small number of very big players that are incredibly successful, incredibly profitable, and they can afford to invest into all the things you would want to invest into.

Imran Amed: One of the things that comes up in conversations that I have with some of the executives at the helm of some of the smaller, but

still sizable, businesses out there is that there's been kind of an ongoing wave of consolidation in the industry, which has made some of the biggest players even bigger.

You know, most recently we saw LVMH gobble up Tiffany in a \$16.2 billion deal. And as these big players, such as LVMH and Kering on the luxury side and Inditex and H&M [H&M Hennes & Mauritz] on the "fast fashion" side, continue to get bigger, the other players in those spaces are finding it harder and harder to keep up.

Simon London: So Achim, you mentioned the McKinsey Global Fashion Index, which is this ranking of the 20 most profitable fashion companies. It is a fascinating list; it's also a diverse list—lots of different types of companies in there. So what unites them? What are they doing right?

Achim Berg: We've started to publish a list that we call the "super winners." It's a very diverse group, as you say. But you can clearly see some of the big trends of the last couple of years impacting that list.

So athleisure and sports have been top of mind now for a couple of years—double-digit growth. And you can see players such as Nike heading the list and also ADIDAS, and now, Lululemon [Lululemon Athletica Canada] and EnterSports [EnterSports Management] have entered that list.

You can see that other trends, such as luxury at the top end of the market, are represented: LVMH,

Kering, MS. But you also see the discount players that have done quite well in recent years on that list—T.J.Maxx, as an example. So we see a lot of the trends that have impacted the market also coming through—through the size, but also the profitability, of those businesses.

Simon London: Imran, anything you'd add to that?

Imran Amed: Yeah, I think the other thing is the power of brands. And if you look at this list, while they may be at different—positioning in the overall market all the way from value to luxury—what you do notice is brands are still really, really important in this industry.

Nike, LVMH, Lululemon, and Burberry: these are all examples of really powerful brands. And while operational efficiency and staying in touch with where the consumer wants to shop, when it comes to retail and omnichannel and some of these other things, continue to be really important, we shouldn't underestimate the importance of brands. A lot of these bigger players that are generating disproportionate amounts of economic profit can invest more in their brands. And in this age that we live in, which is very similar for other consumer-facing industries, a lot of that investment is happening in the digital sphere and creation of content on social media.

And these companies, especially the high-end fashion companies, what they've always specialized in is creating really, really beautiful, high-value

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content that creates some kind of emotional response or reaction within the consumer base. That has now taken to a whole new level on social-media channels, and it's happening on a daily basis.

So we've gone from this environment where these companies are planning quarterly ad campaigns linked to seasons, and they're now moving to more robust, always-on content campaigns, events, and immersive experiences, all of which play out on social media all the time. And so the power of the brand is still really important.

Achim Berg: I think it's also interesting what we do *not* see on that list. You do not see any department stores on that list. You do not see any pure-play players, marketplaces, on that list. You only see now two additions from Asia that are new on the list. So we didn't have an Asian player on the top 20 last year.

And I think that also tells you something. There are certain business models that are in decline. There are others, such as the digital players, that are going for market share more than for absolute profitability. And we should also expect to see more Asian players on that top 20 list going forward.

Simon London: I think it's always worth pointing out that these are all publicly listed companies, right, because we need access to the public data to do the calculations. And there are some very meaningful privately owned players in fashion, that, if the data were available, might be on the list. That's right, isn't it?

Achim Berg: So you're right. The list is based on publicly available data; therefore, we are using listed companies. But it's also important to recognize that there are a significant number of privately owned companies out there that are also quite sizable, yeah.

So we have companies that have more than ten billion in turnover, such as Chanel, but you also get a lot of companies that are somewhere between one billion and five billion, seven billion, or eight billion in turnover. Not to talk about the hundreds and hundreds, probably thousands, of companies that

are somewhere between a couple of hundred million and a billion in turnover. So a lot of the business is still privately owned, and that is a very significant part. We still believe that the publicly available data give us a good proxy on what's going on in this industry.

Simon London: Could we just talk a little more about Asia? You mentioned that a couple of Asian companies are now on the list of value creators. What else is going on in the very big Asian market?

Imran Amed: Well listen, one thing that hasn't changed is that China remains the single-most important market in the world and in the fashion industry and continues to drive a disproportionate share of growth. However, it is worth noting that growth is slowing in China. And so one of the trends that we've identified for the state of fashion in 2020 is that there are other markets. And there's 1.2 billion consumers under the age of 30 in a range of countries, from the Middle East to Southeast Asia and India.

I think that's really important to note. Because although lots of fashion companies have been kind of razor focused on China in recent years—as they should be—what we were trying to underscore is this: as the Chinese market does begin to slow down a bit, while remaining important, it's worth considering and reevaluating their strategies and thinking for some of these other markets where there's an even younger, very hungry, emerging consumer base that is looking to connect with the fashion industry.

The long-term fundamentals of India and Southeast Asia, Saudi Arabia, the United Arab Emirates, and these other emerging markets remain very important for the industry to consider.

Achim Berg: In addition to what Imran just said, I think it's interesting to understand that competition is also increasing from China—and from the Asian markets, in general. You see that when you look at the top 20 list, where now Anta (PH) and HLA made it among the top 20. They weren't there last year.

The whole business has become much more borderless and volatile. And Asian players will take that to their advantage and will be even more present on the Western markets.

Imran Amed: I think, for a long time, our industry has thought of Asia in respect of two key dimensions: first being the workshop and manufacturing zone, and second being the growing consumer base. But there's a third dimension where Asia's playing a stronger and stronger role: in Asia, we're starting to see real competitors develop, as they move further up the value chain and start becoming direct competitors to some of the brands in the West.

And you know, there was this kind of phenomenon over the past year called "the Amazon Coat," which became a viral sensation on social media. But as it turns out, the manufacturer made \$5 million in sales in one month—more than the company's entire revenue for 2017—from this coat. And it was a Chinese manufacturer that produced this coat and then distributed it on Amazon.

Simon London: So that's a nice segue to the fashion-tech sector. And we actually have fashion-tech unicorns now—fashion start-ups with billion-dollar valuations. So the obvious question is, how serious are these as competitors to the really big brands? .

Achim Berg: We are quite proud that we've foreseen at least some of the unicorns that you're referring to. Last year, we looked into a trend that was called "the end of ownership." And it was not only renting merchandise; it was also the resale of preloved products. And we felt there was a bigger trend hitting the market.

The valuation of Rent the Runway is a very good example underpinning that. But we also see that players such as StockX, ABOUT YOU, and Allbirds have achieved valuations of \$1 billion and more, which underscores the relevance of fashion tech. It's where the fashion side of the business collides with technology.

And in the second tier, you see players, such as ThirdLove and Moda Operandi, that are active in lingerie or luxury fashion and get high valuations—and that is, in the end, a reflection of the appreciation they get from the consumers.

So there is a whole part of the industry that is different and much more tech driven than it used to be. It's not the old game of a great designer that has just has the right silhouettes and colors and handwriting and is therefore celebrated by the market. There's a whole new dimension to that play.

Imran Amed: The one thing I would just add, as a note of caution, is that I suspect—and I think Achim would probably agree—that there's a bit of a bubble effect happening here, especially around some of these direct-to-consumer companies that have raised a significant amount of capital at very, very high valuations. And some of these companies are having to spend a lot of money on customer acquisition in order to continue to meet their growth targets, which makes the long-term profitability prospects for these companies questionable.

We've also seen a similar phenomenon this year with Farfetch [Farfetch UK], which has, for the past few years, been a company that the industry has been watching very, very carefully. It did a very successful IPO about a year ago. But over the past year, as the competition in the market around e-commerce—and particularly luxury e-commerce—has continued to grow, a lot of the players have had to spend a lot of money on marketing and customer acquisition, and this has kind of deteriorated margins.

So it will be interesting to watch this space: although it's buoyant, and there are all these new players, there will be a shakeout at some stage. And I think—particularly as we enter an economic environment that seems to be darker and maybe more challenging—the bar will be raised for these players in terms of actually being able to deliver on all of the expectations.

Simon London: Now you mentioned that some of the fashion-tech players are focused on previously owned or rented fashion, which is in tune with the zeitgeist around reuse- and circular-economy-type principles. I also noticed in this year's survey that executives said sustainability is both the number-one challenge and, indeed, the number-one opportunity for the industry! So just say a bit more about sustainability and how the fashion industry is positioning itself and responding.

Imran Amed: So as an industry, one of the biggest challenges is to get a common understanding. Yes, while this is a big opportunity, and yes, it presents a huge challenge, what exactly is sustainable fashion? It's not quite as easy as you see in some of the other sectors.

The inherent challenge is, as an industry, in order to continue growing, we are driving consumers to purchase more, to consume more. And actually, there's this dilemma: as we drive more consumption, we're actually growing the carbon footprint of the industry.

So I think, as we look to next year, there is this dilemma around growth: How do we continue to have growing profitable businesses while addressing the kind of carbon footprint, the sustainable footprint, of our industry? And so, I think about it as, yes, a challenge but also finding that common understanding and recalibrating what we see as being a healthy way for this industry to exist. And that sounds maybe slightly conceptual or philosophical. But I do think it's an underlying challenge.

Achim Berg: So we should all go undressed?

Imran Amed: No, I think it's that, as we observe consumption in our industry, the biggest challenge is really around fast-fashion companies and the consumer behavior that we've been encouraging, which is people purchasing items of clothing. And sometimes they're only worn once or twice before they're discarded, or they're sitting in a closet. I think the average US consumer now purchases

something like 60 new garments of clothing per year—or more than that.

You know, there is a dynamic here that we've trained the consumer to pursue, which is not consistent with the industry's supposed goals of becoming more sustainable. And I see an inherent contradiction there. It feels like the elephant in the room. And that seems like an area that we, as an industry, are really going to have to get our heads around.

Achim Berg: And I think, to make things even more complex, that's very much a perspective on the Western and developed markets. You still have big emerging markets, as we discussed earlier. And in the big emerging markets, one of the categories that is boosted when growth pushes the middle class is clothing. So that's where people spend a significant share of their wallet—on apparel. And I think it's not a solution to prevent people from doing that. So we probably need to find solutions on doing that in a less harmful way to the planet.

And as a matter of fact, the fashion industry is a dirty industry. People don't like that to be pointed out. But the way we still produce a lot of garments in the industry is not very efficient: more than 70 percent of products end up unused. And also, the way we produce has some issues—the water treatment, the pollution that comes with it, labor rights.

I think it comes back to your terminology aspect. What do we really mean with “sustainability”? But if you take a closer look, it's not a very nice picture. And therefore, I think the industry has an obligation to improve that.

Imran Amed: And we need to think about, in addition to impacts on the environment, the impacts on the people who make our clothes. So one of the things I think, as an industry, we're really going to have to get our heads around is that we're producing garments—sometimes in very, very questionable conditions—and not paying people enough to make those clothes, just so we can provide cheap, fast fashion to consumers, often in the West, sometimes

in the East. And that's a very, very challenging conundrum to get our heads around. And I think this is the thing that we need to get out and really discuss openly now, especially as it's front of mind.

According to our executive survey, sustainability has appeared at the top of the list for executives, which is the first time in the history of this survey. So I think that's the silver lining here: executives have finally taken note. And I think it's time for us, as an industry, to really look at this and face it head on.

Simon London: I'm intrigued by fast fashion, which you mentioned in there. But you know, I would have thought that the fast-fashion business model is particularly challenged in a world in which a lot of consumers care deeply about sustainability. Does fast fashion have a future?

Imran Amed: I think it has a future but not in its current form. And I think with the fast-fashion players—a couple of which appear very highly on this list of super winners—if you have an honest, private conversation with executives who work there, off the record, they'll talk to you, and there is an existential crisis happening amongst these players because they understand what's going on in the market.

They understand shifting consumer sentiments. The consumer focus and sentiment around the fast-fashion segment is really beginning to shift, especially amongst informed consumers in the kind of Generation Z and millennial cohorts, who are increasingly stepping back and saying, "Listen, I'm looking ahead."

I see Greta Thunberg in the streets with hundreds of thousands of climate protesters having these school strikes. I see the extinction rebellion in the streets shutting down huge parts of London. And it's building awareness—mainstream, mass awareness—around climate crisis.

I think these things are really going to become a collision at some stage. So if you're an executive at one of these fast-fashion players, and you're observing the change happening in the market, I'm sure you're thinking, "Wow, we're going to have to really radically rethink how we, as a business, exist."

I don't think it means there's no future for these companies. I just think it means, for the business model, just as they've been so creative and thinking about building responsive supply chains and making sure they address the trends and things that consumers are after, they have to apply that same level of thinking and innovation to the way they manage their supply chains—so they're not quite so damaging to the environment.

Simon London: Talking of supply chain, we haven't really touched yet on the fashion store and the role that it plays. We talked about direct-to-consumer business models; we talked about the impact of the big e-commerce platforms. What does all this mean for the future of the fashion store? What role does it play in this changing world?

Imran Amed: The store definitely has a future. But I think what we've started to see is that the store is playing a different role now than perhaps the transactional role that it played in the past. And whereas our industry was formerly focused on a very simple chain of events that would drive consumers to a store—a collection would be designed, advertisements would be published, consumers would see advertisements, and they'd go directly to a store—that customer journey has radically changed.

And what it means is, consumers are obviously getting information on digital channels now, and they're also able to transact on digital channels. The store therefore performs an additional role, which is to really service that consumer and immerse them in the brand—to give them the access, education, and service that they can't get on a digital platform or an e-commerce platform.

And I think the most innovative retailers are understanding how these digital and physical channels work together. I think people who are talking about the retail apocalypse and the end of the store are incorrect. I mean, yes, there is a shakeout happening on high streets. But in all of those places where you see stores closing, you see new ones opening up. In fact, some of them are the stores of brands that used to be digitally native brands—that didn't have any physical presence. And the fact that companies such as Away and Glossier and some of these other ones are actually building physical stores shows that, even for digital brands, having a physical presence is a really important part of creating that connection with the customer.

Achim Berg: I couldn't agree more. I think it's not digital versus offline; I think it's, in the end, all a combination. And call it "omnichannel" or "digitally enabled retail": in the end, it needs to satisfy consumer needs. And there are different needs.

There's a convenience need that online is typically very good in serving. There is a need for entertainment and excitement that a store, in many ways, is better able to serve. But there's also a need for some neighborhood shopping. And if you look at the trends that we've identified in the new report, we see that there is a trend toward that neighborhood store.

But it's not just the kind of small store that is convenient and close by. It's a digitally enabled store where some of the leading players look into

how you can use the information you get from your e-commerce, from your loyalty systems, and from all the other stores you have to provide an offering that is tailored to a specific neighborhood. And we believe if you use modern technology and data, you have a good opportunity to also enable offline stores to be successful.

Simon London: Yeah. So the future is, indeed, omnichannel?

Achim Berg: The future is omnichannel.

Imran Amed: I'd say the present is omnichannel. It's already there. It's just, in some cases, a matter of some of the players catching up with where the consumer's been already for a few years now.

Simon London: Okay, so I think we are out of time for today. Imran and Achim, thank you so much for a fascinating conversation about the state of fashion.

Achim Berg: Thank you very much, Simon, for the good discussion.

Imran Amed: Thanks for having me. It's great to be on the *McKinsey Podcast*.

Simon London: And thanks, as always, to you, all of our listeners, for tuning in to the *McKinsey Podcast*. If you enjoyed it, please do subscribe to the series on your favorite podcast app. And to read more about the state of fashion, retail, sustainability, and more, please visit us at [McKinsey.com](https://www.mckinsey.com).

Imran Amed is the founder, CEO, and editor-in-chief of Business of Fashion; **Achim Berg** is a senior partner in McKinsey's Frankfurt office. **Simon London**, a member of McKinsey Publishing, is based in the Silicon Valley office.

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