

Apparel, Fashion & Luxury Group

Revamping fashion sourcing: Speed and flexibility to the fore

McKinsey Apparel CPO Survey 2021



Authors

Saskia Hedrich

Julian Hügl

Patricio Ibanez

Karl-Hendrik Magnus

Contents

- 4 Introduction
- 6 Supply-chain disruptions are here to stay
- 10 Shocked into renewal: The transformation accelerates
- 12 Simplifying the assortment: Managing the costs of speed and flexibility
- 20 Deciding sourcing-country mix: Stability and flexibility drive decisions
- 23 Forging partnerships: Apparel brands and retailers can't go it alone
- 27 Smartening up sourcing: Digitization still has a ways to go
- 29 Moving to a more integrated operating model
- 32 Accelerating for success

Introduction

A decade after the first edition of McKinsey's Apparel Chief Purchasing Officer (CPO) Survey, this sixth edition appears in a much-changed world. Even as some countries recover from a catastrophic pandemic, apparel sourcing faces a perfect storm of challenges: demand volatility, supply-chain disruptions, rising costs, and profit pressure.

These challenges have thrust the supply chain to the top of the agenda of fashion chief executives around the world. To address them, a fundamental shift toward a sourcing model that is flexible, fast, sustainable, digitally enhanced, and consumer-centric is required. This transformation will need to span all areas of the product-development process.

In this report, we assess the industry's progress on this journey to date and look ahead to 2025—drawing on the reflections of 38 CPOs who have taken the time to assess their own organizations' trajectories. Our respondents represent international apparel and sportswear brands and retailers—a mix of industry leaders and SMEs—which together command roughly \$100 billion of sourcing volume. Two-thirds of the CPOs surveyed are from European companies, and almost a quarter are based in North America.

A transformation is underway

We find that half the companies surveyed have embarked upon major transformations, jump-started by the pandemic: they are changing up their operational and design processes, their sources, and their ways of working.

Assortment decisions are shifting, with brands using advanced analytics and virtual pretesting to refine their

product lines. Design adoption rates are set to rise, with reduced product complexity. Fabric consolidation, platforming, and fabric prebooking will become even more common. Sustainable materials and 3D design are significant trends, while designs developed by vendors or in-house in sourcing offices will also play a greater role.

Due to travel restrictions and supply-chain disruptions, there's been a surge of alternative approaches to sampling. **Nonphysical sample approval** is here to stay, with virtual sampling proving more popular than video sample assessment.

Apparel companies are also looking to **change their sourcing-country mix**, turning their attention to reshoring, and particularly nearshoring, to secure the supply chain. Overall, the focus on speed and flexibility is leading to more diversified and complex strategies: dual or multicountry sourcing to increase in-season reactivity, and analytical sourcing decision making.

It has become vital to forge **strategic links with trusted suppliers**, especially those that invest in digitization, and are fast and flexible regarding production cycles and batch sizes. Long-term, committed relationships with key suppliers are increasingly favored.

Digitization has emerged as a vital element of success. The industry has made clear progress here: digitizing interfaces, introducing advanced analytics, improving operational and design processes, and aiding transparency.

Companies need completely **new operating models** to manage the increased complexity. They are working

to overcome siloed structures and the tendency to prioritize cost concerns over net product margin.

Our recommendations

We propose a set of bold moves to cope with ever-changing customer demand. The successful organization of the future will completely revamp their operating model when it comes to tools, capabilities, and processes—and the role of their sourcing teams.

CPOs can take responsibility for turbocharging the adoption and ownership of digital tools, while filling the digital skills gap. Flexibility and speed can be maximized, while protecting margins, with a strong network of supplier partners. And finally, with improved calendar management, an end-to-end (E2E) mindset can be enabled across the organization, presenting solutions for the apparel industry of today—and for the uncertain years ahead.



Supply-chain disruptions are at the top of the agenda of fashion chief executives around the world.

Supply-chain disruptions are here to stay

The challenges facing the apparel-sourcing sector—demand volatility, logistical disruptions, cost pressures—are tougher than ever. Most players in the sector recognize a need for more consumer-centric and sustainable operating models, and the ramped-up speed and flexibility these require.

While discussion around demand-driven supply models has been going

on for years, only a select number of brands and retailers have transitioned to the agile, digitally and analytically enhanced sourcing models best matched to current conditions.

COVID-19, however, has brought greater urgency. Pandemic disruption put immense strain on brands' and retailers' sourcing organizations, as well as on manufacturers.¹ This brought

sourcing issues to the fore: for the first time, supply-chain concerns are mentioned as the number-one challenge by global CEOs and executives. (See our upcoming report, "The State of Fashion 2022.")²

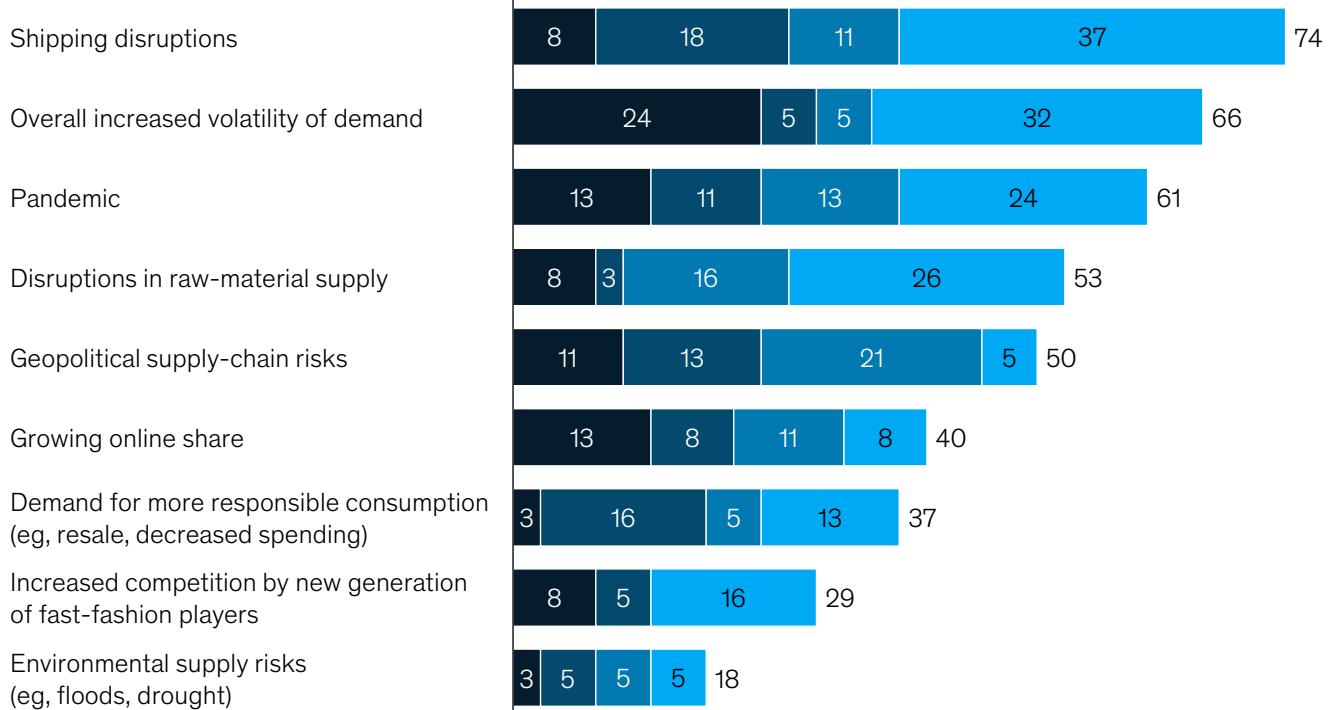
Exhibit 1

Shipping disruptions are top of mind, with demand volatility close behind

"Which demand forces and supply risks impact your company's future approach towards speed and supply-chain flexibility most?"

Percentage of respondents

■ Top 1 ■ Top 2 ■ Top 3 ■ Top 4&5



Source: McKinsey Apparel CPO Survey 2021

¹ Achim Berg, Lara Haug, Saskia Hedrich, and Karl-Hendrik Magnus, "Time for change: How to use the crisis to make fashion sourcing more agile and sustainable," McKinsey & Company, May 2020, mckinsey.com/industries/retail/our-insights/time-for-change-how-to-use-the-crisis-to-make-fashion-sourcing-more-agile-and-sustainable.

² "The State of Fashion 2022," Business of Fashion and McKinsey & Company, December 2022 (forthcoming).

Supply-chain stumbling blocks

Shipping disruptions: Harbor shutdowns, port congestion, container shortages, and capacity issues in sea and air freight have all contributed to delays (up to three weeks in September, depending on source country). For example, the availability of container vessels is down 11 percent from last year. Demand surges have only added to the strain. These issues will persist into 2022, and potentially beyond: consolidation in the shipping industry might lead to reduced fleets, while in the medium term, more restrictive EU regulation of ship engines may result in selective bans of vessels in certain ports.

Volatility of demand: Uncertainty in the apparel sector has been prevalent for some years, as we've discussed in previous reports. Now, post-COVID-19, we see uneven recovery and demand spikes. European and US consumers' pent-up clothes-spending power has been released, straining production and transport capacities. At the same time, a growing income gap is putting even more pressure on mid-price segments.

COVID-19: Three out of five CPOs surveyed listed the pandemic as one of their top five impacting factors: Whole country manufacturing bases are still ramping up, or down, in its wake. Uneven global recovery vaccination rates will continue to impact business for at least the next year, as will the shift from pandemic to endemic disease conditions.

Raw materials: The main Asian sourcing countries are beset with supply issues, as the flow of raw material from China is hampered by longer lead times, the Xinjiang cotton block, and power shutdowns. Other countries, too, fear energy or power shortages and price hikes hitting the textiles industry. Beyond Asia, a shift to nearshoring is made difficult by limited raw-material supply, and, at times, hefty price markups. Regarding sustainable materials, one in three respondents say they plan for more than 90 percent of their product to be made with sustainable fibers by 2025, and two-thirds put this figure at half at least—but a broad industry shift to more sustainable raw materials is increasing feedstock uncertainty.

Online sales: During COVID-19, there was a surge in online sales and digital adoption rates, with many new users added. Even with stores reopening across the US and Europe, this change is here to stay: Online sales will not fully revert to prepandemic levels.³ At the same time, the new generation of online fast-fashion players is growing: in the US, Chinese company Shein has more than doubled its market share, taking the fast-fashion lead in 2021.⁴

These are not simply short-term disruptions, and they are challenging the fashion industry to undergo fundamental changes. Future demand forces and supply risks will only accelerate the transformation.

³ Neira Hajro, Klemens Hjartar, Paul Jenkins, and Benjamin Vieira, "What's next for digital consumers," McKinsey & Company, May 2021, mckinsey.com/business-functions/mckinsey-digital/our-insights/whats-next-for-digital-consumers.

⁴ "Shein Now Leads Fast Fashion," Earnest, June 2021, earnestresearch.com/data-bites/shein-leads-fast-fashion/.

Recycled fibers ramping up

Recycled fibers form a significant part of companies' sustainable material strategy: roughly a quarter of respondents intend for more than half of their products to utilize recycled fibers (though recycled fibers had a less than ten percent share in the global fiber market in 2020).⁵

The recent increase in use of rPET (recycled polyethylene terephthalate) from plastic bottles is expected to continue. In commercial commitments to more sustainable and circular materials, open-loop recycled polyester currently plays the biggest role, as price premiums are lower than for other recycled materials. A quarter of surveyed companies plan to replace at least half of their virgin polyester products with rPET from bottles over the next few years.

However, survey respondents are also extremely optimistic about the development of closed-loop recycling (though 2020 still saw a less than 0.5 percent market share for pre- and postconsumer recycled textiles).⁶ By 2025, 21 percent of respondents aim to replace at least 30 percent of their virgin cotton with mechanically recycled cotton; a quarter of companies wish to use garment-to-garment recycling in at least 30 percent of their polyester products; and a quarter will do so in at least 30 percent of their viscose items.

Given the current state of recycling and the time frame, these targets may seem more than ambitious. With competition for feedstock rising, capacity issues and medium-term price hikes are apparent. However, as new recycling technologies move to industrial scale, the global industry is coming together to solve the challenges of collection, sorting, and recycling on a systemic level. Industry leaders have recognized that access to raw material is a major competitive advantage. We will see even more direct investment into sustainable and recycled materials by apparel brands and retailers, to speed up scaling and secure supply.



24%

of companies plan to make at least half of their product with recycled fibers by 2025.

⁵ "Textile Exchange Preferred Fiber and Materials Market Report 2021," Textile Exchange, August 2021, textileexchange.org/textile-exchange-preferred-fiber-and-materials-market-report-2021/.

⁶ *Ibid.*

Costs on the rise

The end of the era of sourcing-cost deflation was never as apparent as it is today, as we see sourcing executives' highest-ever expectations of price hikes—on average, three times greater than we found in our 2019 survey.⁷ For the first time in ten years, shipping costs are the leading driver of this concern, followed by raw-material costs—a shift from the 2019 focus on forex rates and labor costs.

High demand and supply-chain disruptions have pushed up ocean price-spot rates by a factor of four to five. Shipping prices are expected to stay high: Capacity will remain limited, and further consolidation of shipping companies may lead to more pricing discipline. Traditional freight forwarders are at risk due to the enhanced capabilities of shipping companies, as well as digital attackers. Additionally, the cost of CO₂ certificates for fuel is expected to increase transport costs.

Recently, raw-material prices have been surging, with cotton and polyester prices increasing by more than 30 percent within the last year. Looking at longer-term price trends reveals, that this is partially a reset after a dip. Prices aren't at historic levels. Further price increases are expected, due to a shift to more sustainable materials as well as price markups on materials in nearshore markets.

Labor costs received less attention, as many sourcing countries put wage rises on hiatus during the pandemic. This is coming to an end, with the pre-COVID-19 trend toward increased wages reasserting itself.

Given this inflationary environment, many sourcing executives are unconvinced that changes to their sourcing strategy will contribute significantly to cost reduction. Roughly four in ten believe that a 2.5 percent reduction in price per piece is the maximum attainable.

Also evident is a gradual shift of focus from input cost to net product margins. Nearly three out of ten companies are planning for a five- to ten-percentage-point increase in the share of products sold at full price, while another 29 percent are aiming for more. However, this will require more than just better planning, shorter lead times, and more in-season reactivity to cut down overstocks.

Slashing markdowns will not be enough to safeguard margins. Higher retail prices are required as well—which means companies need to work much harder to convince consumers once again of the enduring value of fashion.

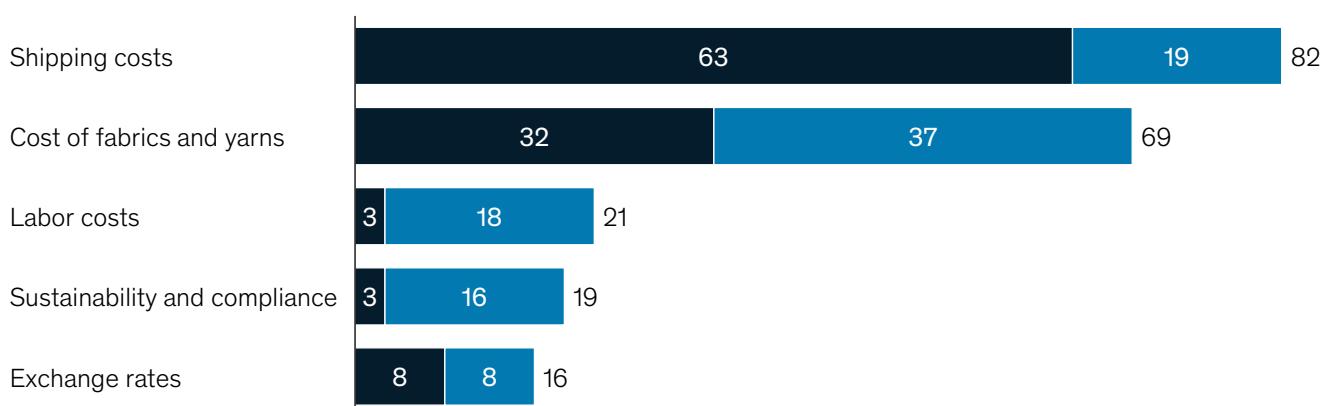
Exhibit 2

Inflation of shipping and material costs is putting increasing pressure on margins

"Which drivers do you expect to have the highest impact on sourcing cost development within the next 12 months?"

Percentage of respondents

■ Very high impact ■ High impact



Source: McKinsey Apparel CPO Survey 2021

⁷ Achim Berg, Saskia Hedrich, Patricio Ibanez, Sara Kappelmark, and Karl-Hendrik Magnus, "Fashion's new must-have: Sustainable sourcing at scale," McKinsey & Company, October 2019, mckinsey.com/industries/retail/our-insights/fashions-new-must-have-sustainable-sourcing-at-scale.

Shocked into renewal: The transformation accelerates

50%

of companies have started a major transformation to achieve speed and flexibility.

At the core of a successful transformation for speed and flexibility is cross-functional collaboration between all players. Here we take stock of the fashion-sourcing industry's overall transformation journey—in which many apparel companies have been jolted into a new trajectory.

The pandemic jump-started this move: it prompted companies to boost agility and shorten lead times, shifting them toward demand-driven supply chains. Half the companies surveyed have set out on major transformations of their product-development processes. Thirteen percent have implemented significant changes, and almost a quarter are running pilots.

Sourcing offices are under review, with a quarter of companies planning radical changes to the role these play. (There's a large group of companies, however, which puts less emphasis on the role of the sourcing offices, seeing more urgency in other functions.)

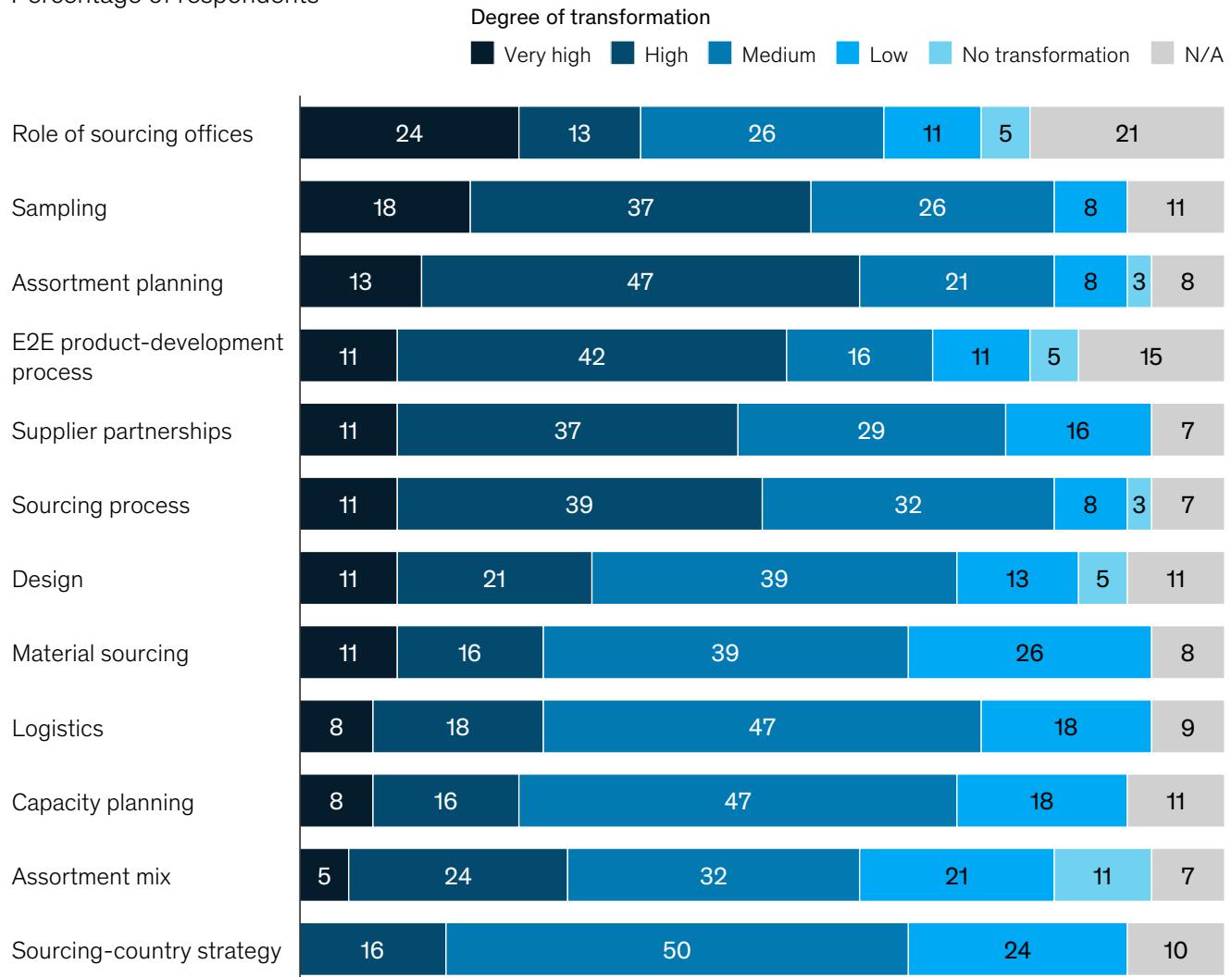
Six out of ten companies plan for a high or very high degree of change in their assortment planning. This will include, for example, integration of new customer-insight tools, reduction of assortment complexity, and radical restructuring of the assortment mix. End-to-end (E2E) product-development processes are also in focus for a majority of companies (53 percent). Sourcing processes themselves will look markedly different in 2025: digitization and analytics require a significant organizational revamp, as do other new ways of working.

Exhibit 3

Transformation along all steps of the product development process

“In which of the broad activity areas along the value chain will your company transform most for speed and flexibility by 2025?”

Percentage of respondents



Source: McKinsey Apparel CPO Survey 2021

Simplifying the assortment: Managing the costs of speed and flexibility

For most apparel segments, the old way of working—dictating to the consumer what to buy, after lengthy planning and development—is long over. However, the industry so far has had difficulty adapting to changing demands, as

notoriously high mark-down levels (even prepandemic) have shown.

Demand and supply disruptions during the pandemic were a catalyst for change. Instead of simply pushing more product

into the system, many companies pivoted to designing their assortment more smartly with analytics; becoming more customer-centric; designing products and utilizing fabrics more efficiently; and implementing digital tools.

The shift to less is more

In the public perception, a fashion assortment featuring increased speed and flexibility equates to a proliferation of short-lived products. Our survey clearly shows, however, that this is not what the majority of the industry is aiming for. Major goals expressed by our respondents are improving the share of product sold at full price, and increasing demand-planning accuracy to avoid overstocks.

Accuracy aspirations continue to grow: One in three companies plan to improve demand planning by ten to 20 percentage points by 2025, and a further 13 percent are aiming even higher. At the same time, 58 percent of respondents hope to boost the share of products sold at full price by more than five percentage points (one out of three even by more than ten percentage points).

We will see an increasing polarization in assortment strategies to meet these goals. Most surveyed companies plan to follow a “less is more” approach: moving to greater in-season reactivity,

while reducing assortment options and complexity.⁸ Often, the numbers of options offered to consumers have grown over the years—in reaction to demand volatility, and because of a lack of customer-centric planning and product development. As pandemic-related supply-chain and demand disruptions ensued, many companies took a hard look at their assortment and started to weed out unprofitable products. This process is ongoing: One out of three companies plan to trim their products by 5 to 10 percent over the next four years, and more than one-fifth by 10 to 20 percent. Midmarket players, especially, will cut back, with almost three-quarters aiming to decrease their assortment by up to 20 percent.

There are some players, however, who plan to take the opposite route. In an effort to drive traffic to their online and physical stores, and to keep price comparability with competitor products at bay, they will increase their options. Value players—facing competition

from not only European and US online fast-fashion players, but also new-generation fast-fashion companies with highly integrated, agile-on-demand business models—see a need to increase their options significantly: one in ten hope to do so by 10 to 20 percent, and 17 percent by even more.

No matter which assortment strategy is chosen, amping up in-season reactivity and flexibility will be a key task for product-development and sourcing teams. The ability to act on the latest consumer insights, and the need to control working capital while managing sourcing costs, are clearly motivating companies to change their assortment calendars: Three-quarters are planning to increase their fast-track in-season capsules, more than two-thirds hope to increase “read and react,” and half plan to increase their share of “never out of stock.” Even made to order, which many companies are not planning to implement, will see growth driven by a quarter of companies.

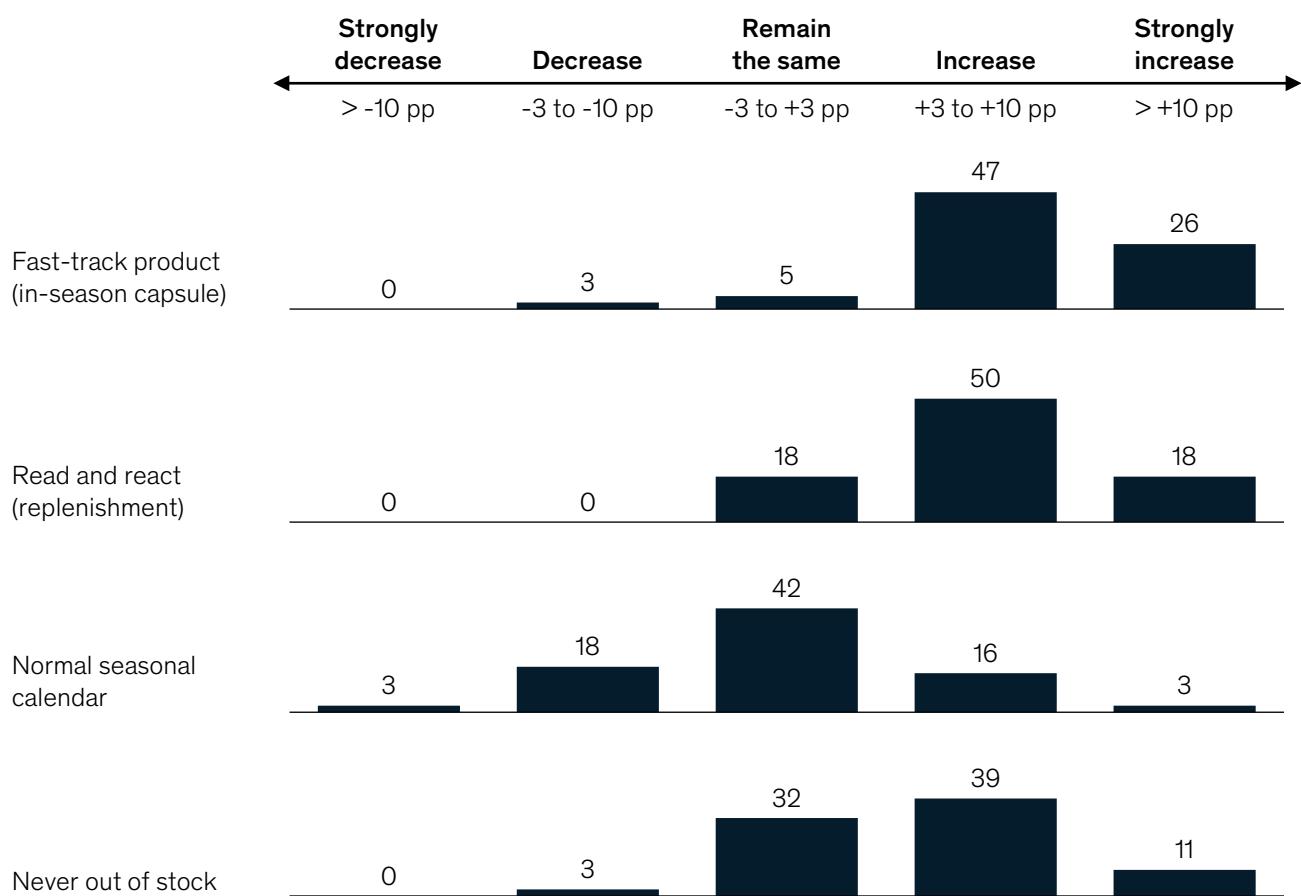
⁸ See also Imran Amed, Achim Berg, Anita Balchandani, Saskia Hedrich, Felix Rölkens, Robb Young, Jakob Ekkeløf Jensen, Althea Peng, “The State of Fashion 2021: In search of promise in perilous times,” The Business of Fashion and McKinsey & Company, December 2020, mckinsey.com/industries/retail/our-insights/state-of-fashion, Chapter 6, “Less is more,” pp 59–66.

Exhibit 4

Companies plan to infuse more in-season reactivity in their assortment

"How do you plan to change your assortment mix to manage demand trends and supply risks by 2025?"

Percentage of respondents



Note: "Not used" and N/A responses not displayed

Source: McKinsey Apparel CPO Survey 2021

Getting creative with platforming and postponement strategies

Customer-centric design is set to become more and more relevant. As we predicted in “The State of Fashion 2021,” brands are sharpening their assortment by using advanced analytics, pretesting with virtual products, and even introducing elements of consumer co-creation or made to order in a bid to gain better insight into sentiment and preferences ahead of production.

Companies hope that better consumer intelligence will increase design adoption rates. Almost a third of companies are aiming for more than 60 percent design adoption by 2025, with 8 percent holding themselves to a success rate of more than 80 percent. To act on shorter-term consumer insights, and to switch from a push to a pull model, agility and efficient processes are key.

We can expect a reduction in product and design complexity to increase efficiency. Design libraries and blocks are important tools here: cutting development time, simplifying costing, enabling design to value, and freeing up the time of design and product teams for where it matters most.

In this area, where creativity and novelty come up intensely against efficiency and cost concerns, fashion companies are persisting with a balanced approach: More than half plan to rely on design blocks from libraries for up to 50 percent of their products; only one in ten will do so for more than 70 percent. (Larger companies over-index here: among companies with greater than \$1 billion sourcing value, 13 percent plan to use design blocks/libraries for more than 70 percent of their products.)

Nonetheless, the use of design blocks and libraries will remain less common than fabric consolidation and material platforming.

Going forward, more companies will not simply source finished products, but will take a closer look at their fabric and material practices, from planning to design and sourcing. There will be moves toward more efficient material management; greater agility in the supply chain; and managing costs as well as working capital.



47%

of companies plan to use design blocks from libraries for up to 30 percent of their products by 2025.

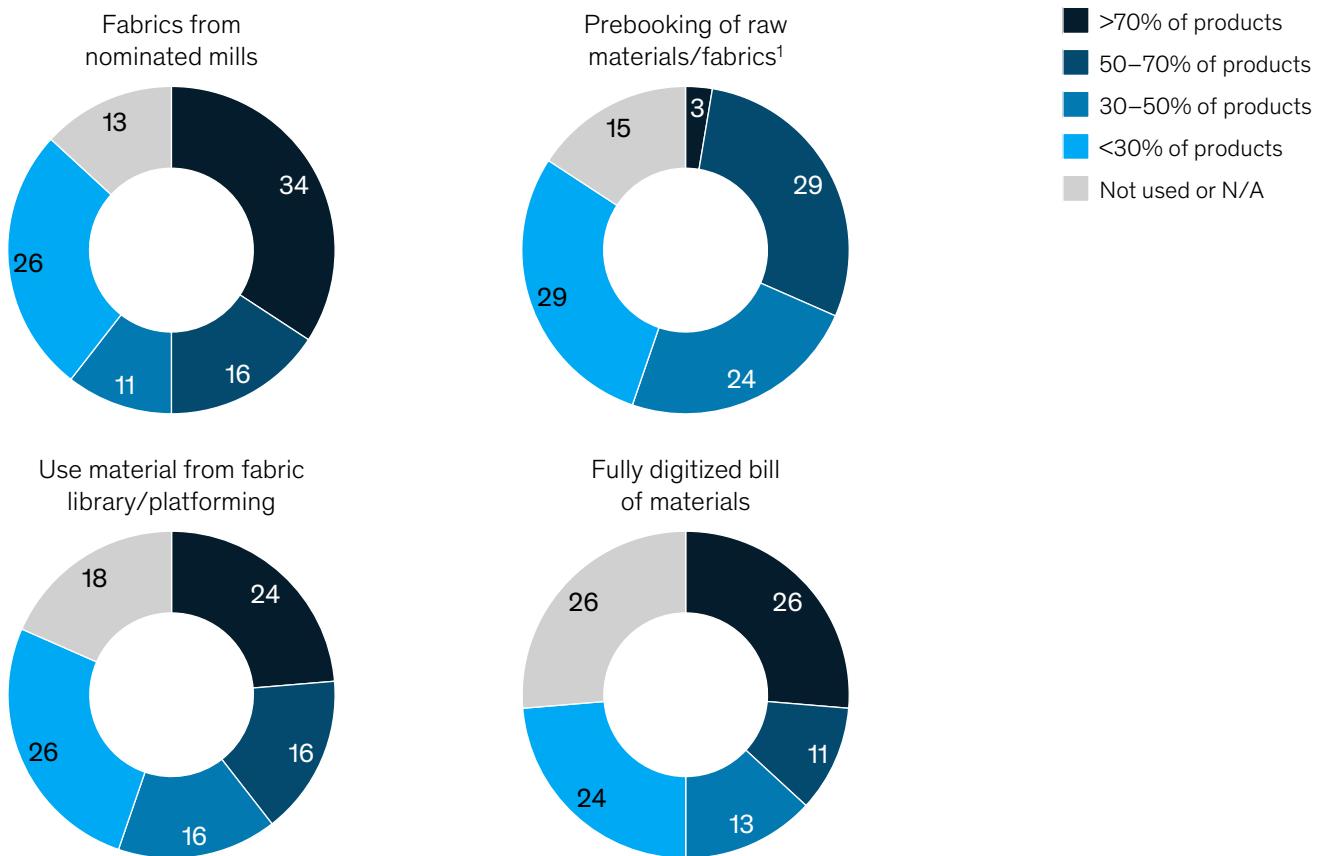
- Fabric from nominated mills:** In the period leading up to 2025, more than a third of companies are planning to nominate fabrics for more than 70 percent of their products; slightly more will do so for less than half of their production. To avoid glitches in the process, suppliers that operate an integrated yarn-to-garment setup will be preferred.
 - Prebooking fabrics:** Postponing decision making on colors and/or styles is a common demand-driven technique for bringing final
- product commitments closer to launch dates, while preloading the time-consuming fabric-production process. The inventory management and cost-of-working-capital benefits of prebooking yarn or fabrics gained additional traction during pandemic supply-chain disruptions, prompting players to increase this practice. More than half of CPOs plan to prebook fabrics for at least 30 percent of their production; about a third plan to do so for more than half their products. (However, this will need to be renegotiated with suppliers, who are asking for new contract terms and payment commitments after experiencing cancellations and full inventory risk during the pandemic.)⁹
- Fabric consolidation and platforming:** More and more apparel companies are optimizing levels of fabric complexity across product teams—prompted by the search for cost savings in a sourcing market that moved from deflation to inflation. Platforming across products on greige, dyed,

Exhibit 5

Companies plan to upgrade their fabric management

“How will your product development process and your capacity planning change by 2025?”

Percentage of respondents planning to apply process for their products



1. Holding inventory at supplier

Source: McKinsey Apparel CPO Survey 2021

⁹ “White Paper on the Definition and Application of Commercial Compliance: Sustainable Terms of Trade Initiative,” Better Buying, Sustainable Textile of the Asian Region (STAR), and International Apparel Federation (IAF), September 2021, betterbuying.org/wp-content/uploads/2021/09/STTI-White-Paper-on-the-Definition-and-Application-of-Commercial-Compliance.pdf.

or printed materials is becoming more common. Roughly a quarter of surveyed companies plan to use material from fabric libraries/platforming for more than 70 percent of their products. Larger companies will implement such efficiency measures across larger parts of their assortments.

Alignment and buy-in across product teams, with clear commitments by designers, merchandisers, and sourcing, is central to successful fabric management. Certain strategies are key:

- Consolidate multiple materials with similar specifications, utilizing core materials across different styles for additional scale.
- Track teams' adherence to volume commitments.
- Embed incentives in key performance indicators (KPIs) and performance management for internal teams as well as suppliers.

Best-practice material-management tools include:

- Single-source-of-truth for fabric and trim details in the PLM/PDM system.
- Digitization of materials for product creation and integration into virtual design processes.
- Adaptive costing and optimization of fabric yield integrated into the design process.
- Digital bills of materials (BOMs) for most products. By 2025, 26 percent of companies in our survey plan to use digital BOMs for more than 70 percent of their products.



Instead of simply pushing more product into the system, many fashion players have pivoted to becoming more consumer-centric.

The changing face of design

Virtual design has revolutionized design, prototyping, and sample approval, and has opened new sell-in and sales opportunities. The days when 3D design was used by only a few front-runners in the industry are over—it's one of the boom technologies in fashion, with new use cases still in development. In design, it is an enabler of speed and flexibility, cutting development time and allowing the integration of cost efficiency. It also facilitates a consumer-centric approach, as more and more companies test virtual designs with consumers to increase hit rates.

No surprise, then, that the majority of companies participating in our survey plan to use 3D design to some degree: 29 percent hope to utilize it

for 10 to 30 percent of their products, while one in five have ambitions to design more than 70 percent of their products with virtual rendering. As companies upgrade their product-development toolboxes, the fashion industry can match this by upgrading skill sets more broadly.

Over the last two years, due to travel restrictions and supply-chain disruptions, there has been a surge in alternative approaches to sampling—ones that do not involve buyers constantly traveling, or the shipping of physical samples around the globe.

Nonphysical sample approval is here to stay, with players reducing sample numbers significantly (in some cases, down to one), and not only cutting

lead times dramatically (by up to four weeks), but also reducing wastage and carbon footprints. However, virtual sampling requires a very high level of trust in suppliers.

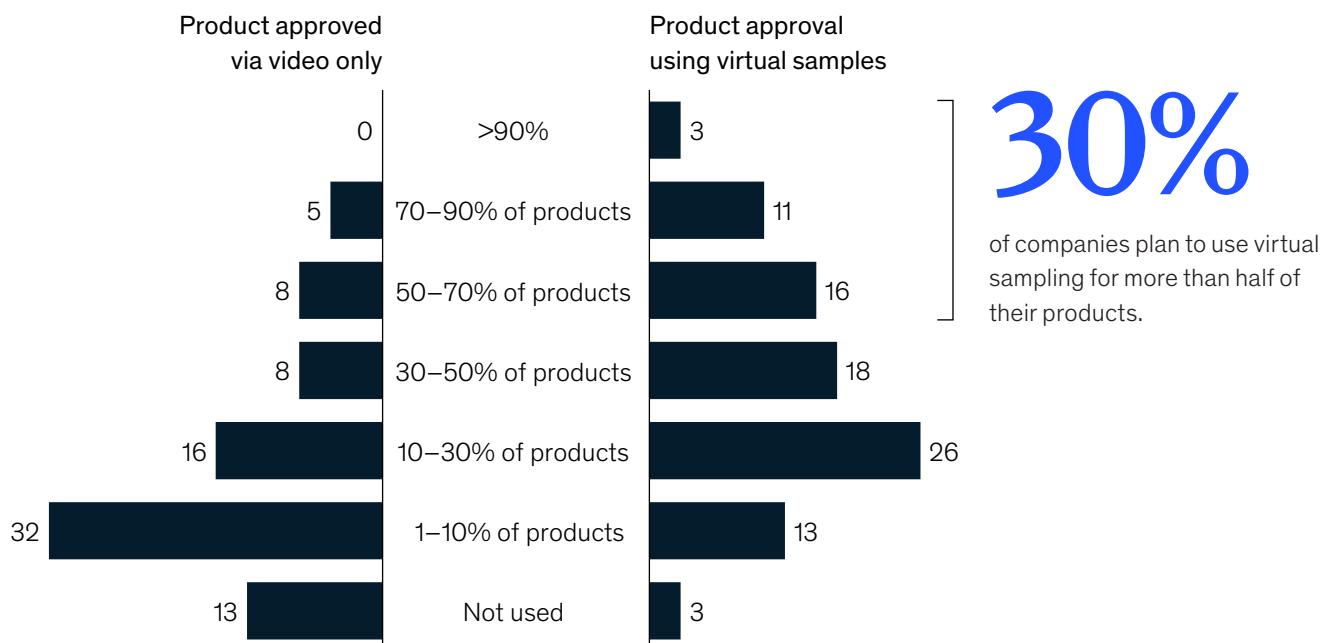
In our last sourcing report in May 2020,¹⁰ opinions on video approval had become polarized, with some sourcing executives expecting it to become common practice, and a similar number seeing it as a temporary solution only. Before virtual prototyping, video conferences had taken the lead in nonphysical sample approval; going forward, however, product approval via video is losing out, with only 13 percent of CPOs surveyed using it for more than half their products—virtual sampling is more than double that.

Exhibit 6

Virtual sampling is becoming standard

"How will your product development process change regarding video and virtual sampling by 2025?"

Percentage of respondents



Note: N/A responses not displayed

Source: McKinsey Apparel CPO Survey 2021

¹⁰ "Time for change", 2020

Moving design and approval closer to production

Besides digitization, companies will be employing a more distributed product-development process: relocating design or sample approval to the sourcing locations, and empowering vendors or local sourcing offices to streamline decision making and shorten lead times.

Vendor-developed designs will play an increasing role, as apparel brands and retailers utilize the creative input of vendors and shorten lead times by buying off the rack. A fifth of CPOs plan to have up to a tenth of their product developed this way, while more than half plan to rely even more on their suppliers. Direct suppliers continue to build up their design and merchandising capabilities. Overall, however, despite the continued trend for decreasing agent share, this is an area where agents and importers are still seen as valuable resources.

Using designs developed in sourcing offices will remain out of the question for 29 percent of companies, although some sourcing organizations have built design capabilities and plan to expand these further. CPOs at 16 percent of companies plan to design up to 10 percent of their products at sourcing offices, while a further 26 percent plan for an even greater share.

Similarly, there is no clear industry trend toward empowerment of sourcing offices for sample approval. This remains highly dependent on assortment mix (especially the share of basics), the operating model for product development, and sourcing-office capabilities. While a fifth of companies entrust approval of more than 70 percent of their products to sourcing offices by 2025, 13 percent plan to do so for 10 percent or less.

What these trends have in common are new ways of working, shared by product teams and suppliers; a need for upskilling internally, and for more skilled suppliers; and a shift in the role of sourcing offices.

Deciding sourcing-country mix: Stability and flexibility drive decisions

Some of the larger sourcing trends we've seen over the last few years continue in this year's survey. Perceptions of country advantages and risks received new nuance, however, given supply disruptions and the need for more demand-focused, flexible sourcing models.

Alongside traditional sourcing decision drivers, country stability has become a very important factor, especially for Asian sourcing markets. The need for flexibility and a changing cost-margin equation also encourages companies to look at options closer to home.

Companies are turning their attention to nearshoring, or even reshoring, to secure the supply chain. This allows them to order closer to launch dates, or to employ dual-sourcing strategies for greater in-season reactivity and options for replenishment.

The sourcing footprint diversifies

We asked survey participants to rank countries according to their sourcing potential over the next few years. The results highlight the current search for balance between sourcing cost and

stability on the one hand, and speed and flexibility on the other.

Of the top five most promising locations, only the two leaders—

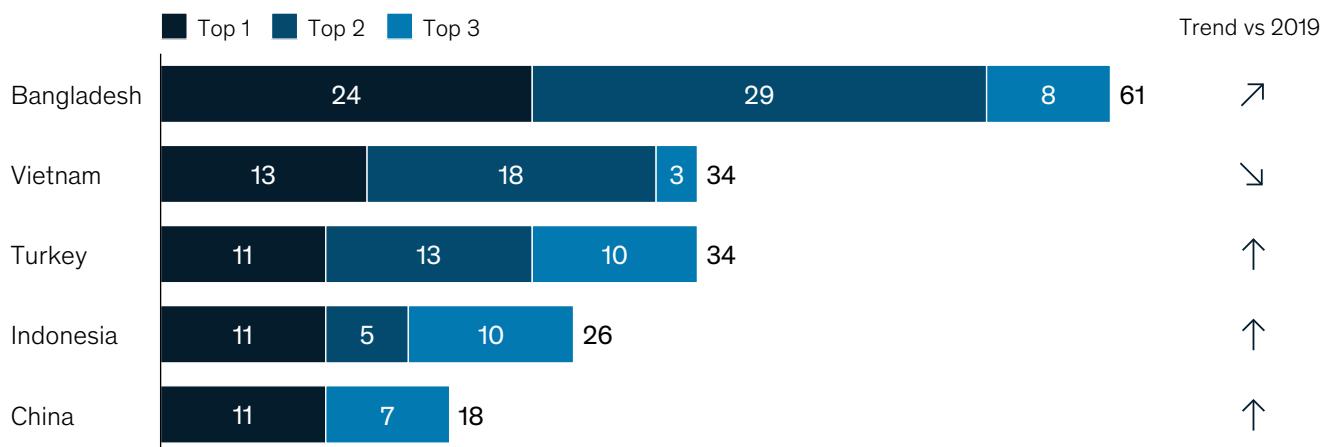
Bangladesh and Vietnam—remain the same as in our 2019 McKinsey Apparel CPO Survey, with Bangladesh being picked as first choice by a quarter of respondents, and Vietnam by 13 percent.¹¹

Exhibit 7

Future view of hot spots significantly impacted by current supply disruptions and nearshoring trend

"What do you see as the top 3 country hot spots over the next several years by 2025?"

Percentage of respondents



Source: McKinsey Apparel CPO Survey 2021

¹¹ "Fashion's new must-have," 2019.

Myanmar, Ethiopia, and India have been relegated to lower places, while for the first time in the last decade a near-shore country, Turkey, has reached the top five, with 11 percent of respondents picking it first—the same percentage that chose Indonesia and China. Despite the relocation of sourcing volumes out of China in recent years, the relative stability of its apparel industry assures the country a spot in the top five sourcing hot spots.

As we know from past predictions, being seen as the “most interesting” future sourcing destination does not necessarily convert into volumes. If we look at companies’ concrete plans for the future, a more accurate picture emerges.

Bangladesh’s key position in the sourcing mix is evident: Six out of ten respondents plan to increase their

sourcing share there in the lead-up to 2025—11 percent by more than ten percentage points. Vietnam, likewise, is expected by 40 percent of respondents to attract increases, despite a number of apparel companies suffering significant losses due to supply-chain delays after Vietnamese pandemic factory closures in 2021. Other South-East Asian countries are gaining volumes too. 32 percent of companies plan to increase their sourcing value share from Cambodia, and 26 percent plan to shift volumes to Indonesia. Only 8 percent aim for an increase in China, and 71 percent in fact anticipate reducing their Chinese sourcing value share—this even before power cuts put a halt to Chinese production at the end of September.

Overall, the focus on resilience and agility will lead to a more diversified country strategy, with a third of

companies planning to increase their number of sourcing countries. Only 11 percent plan to source from fewer countries.

At the same time, dual and multicountry sourcing to increase in-season reactivity will become more common, though it will be reserved for a limited range of the assortment. A quarter of companies plan to apply dual-sourcing strategies for 30 to 50 percent of their products, while more than two-fifths plan to do so for up to 30 percent of their products.

Localized, multicountry sourcing closer to global distributed consumer markets (for example, sourcing in China for the Chinese market) will be less common. One out of three of companies plan to use localized sourcing for 10 to 30 percent of their products.

Doubling down on nearshoring and reshoring—more work required

For years, sourcing executives have been contemplating nearshoring as an option.¹² This discussion has intensified due to challenges such as factory shutdowns in East Asia, logistical logjams, and price hikes; the shift to online sales; and the need for higher in-season reactivity. Seven out of ten executives surveyed expect to increase their nearshoring strategy in the future—13 percent by more than ten percentage points.

Among European companies, this renewed interest in nearshoring is illustrated by a strong shift toward Turkey. This also highlights cheaper production costs due to a declining lira. The growth of Turkey will not be

driven by European players alone: US companies also plan to take advantage of the country’s capacity for design and speed.

For US companies, Central America is highest on the list for future nearshore activities. Roughly 8 out of 10 North American apparel players plan to increase their sourcing value share from this nearshore region.

Reshoring, too, is gaining traction in the minds of sourcing executives. They expect to offset some of the cost disadvantages by semi-automation; but equally important is the consideration of increased full-price sell-through, and decreased markdown.¹³ Some

24%

of sourcing executives plan to increase reshoring in their sourcing strategy.

¹² Johanna Andersson, Achim Berg, Saskia Hedrich, and Karl-Hendrik Magnus, “Is apparel manufacturing coming home?,” McKinsey & Company, October 2018, mckinsey.com/industries/retail/our-insights/is-apparel-manufacturing-coming-home.

¹³ See more about impact on automation on cost and analytically supported sourcing decision making in *ibid*.



71%

of surveyed CPOs plan to increase their nearshoring share.

larger brands, too, are committing to reshoring parts of their assortment: this is no longer the sole domain of niche or fast-fashion players.

However, production capacity for nearshoring and reshoring remains an issue, due to lack of capacity, industry fragmentation, and lack of labor supply. And, as certain cases over the last year have made clear, social compliance and human rights must remain high on the agenda for all countries; near- and reshoring markets are no exception. The raw-material availability gap is also still prevalent, with capacity developing only slowly, and materials priced at times at a noncompetitive premium.

While some manufacturers have launched digitization and automation transformation initiatives and industry-wide moves being under way in some nearshore markets such as Turkey, these elements must still increase to

meet the demands of efficiency and cost competitiveness.

Investment into own-garment production capacity remains the exception for brands and retailers—only 11 percent of respondents plan to use their own production facilities for up to 10 percent of their products over the next five years, with just 8 percent contemplating a greater share.

Beyond nearshoring or reshoring, shared investments with suppliers to develop capacity or to improve efficiency and sustainability are expected to grow slightly: 21 percent of companies are planning shared investments with up to 10 percent of their suppliers, while 16 percent are planning such investments with 10 to 30 percent of their suppliers.

Increased diversity necessitates for more sophisticated sourcing-country

decision making. Alongside the more traditional parameters, it also requires the implementation of intelligent, analytical decision-making tools that take sell-through and product margin into account. Analytic capabilities, therefore, are becoming more important for sourcing departments.

Forging partnerships: Apparel brands and retailers can't go it alone

Strong partners are key in the shift to demand-driven, consumer-centric supply chains. It's become vital to forge strategic links with suppliers, especially those that invest in agility, sustainability, efficiency, and in their workforce.

Apparel brands and retailers are revising their network of suppliers and moving toward closer partnerships to fulfill the new model and achieve sustainability goals, while balancing cost and organizational efficiency. At the same time, pandemic-battered suppliers are joining forces to shape the business relationship.

Taking these developments together, we expect to see consolidation, with some suppliers clearly favored, and closer engagement by brands to safeguard the right type of capacity and relationships. Though the historical power balance of the supply chain remains, brands and retailers are facing increasing competition for the best suppliers.

Winners in the manufacturing landscape of tomorrow

A key focus for apparel brands and retailers is a strong consolidation in supplier base, with 47 percent of the companies surveyed planning to decrease the size of their supply base by up to 25 percent.

There is an ongoing trend to leverage scale effects, and to build a smaller set of larger, more sophisticated, trusted suppliers. With increasing complexity of sourcing decision making, brands are becoming more discerning in their

supplier selection, and optimizing their supplier onboarding and management processes. Cut-make-and-trim-focused suppliers, which continue to rely on old ways of working, are facing increasingly stronger headwinds. The best suppliers



Up to a
25%

decrease in supplier base is planned by roughly half of companies.

invest in technological upgrades, and in upskilling their workforce. Larger, more sophisticated apparel manufacturers are best positioned to handle more volumes.

Certain characteristics of suppliers will be particularly attractive:

- **Digitalization:** Production efficiency and transparency remain key issues in today's supply-chain challenges. Smooth interactions with suppliers via platforms or other digital links are crucial, as knowing production and shipment status on a daily basis is becoming more and more important. Keeping up "manually"—with Excel and email—is no longer an option. Our work with manufacturers shows that leading suppliers invest in semi-automation, artificial intelligence, and Industry 4.0 for real-time production efficiency and quality improvement. A striking 68 percent of survey respondents plan to grow

their number of suppliers with these capabilities—8 percent by more than a quarter.

- **Small batch sizes:** With the greater focus on in-season reactivity, fast-fashion capsules, and test-and-chase strategies, sourcing organizations are tasked to find suppliers who can both deliver smaller batch sizes and offer flexibility to support these programs. Here too the trend is clear: six out of ten executives plan to increase or strongly increase their number of suppliers with small-batch capacity.
- **Vertical integration:** Vertical setups cut out product-development lead time, avoid delivery delays, and ensure raw-material supply, even during supply-chain disruptions. Especially with current fluctuations in raw-material prices, which challenge

manufacturers to keep relationships with mills stable, an internal source for key raw materials (such as fabrics) is a strong competitive advantage. More than half of CPOs plan to increase their number of vertically integrated suppliers.

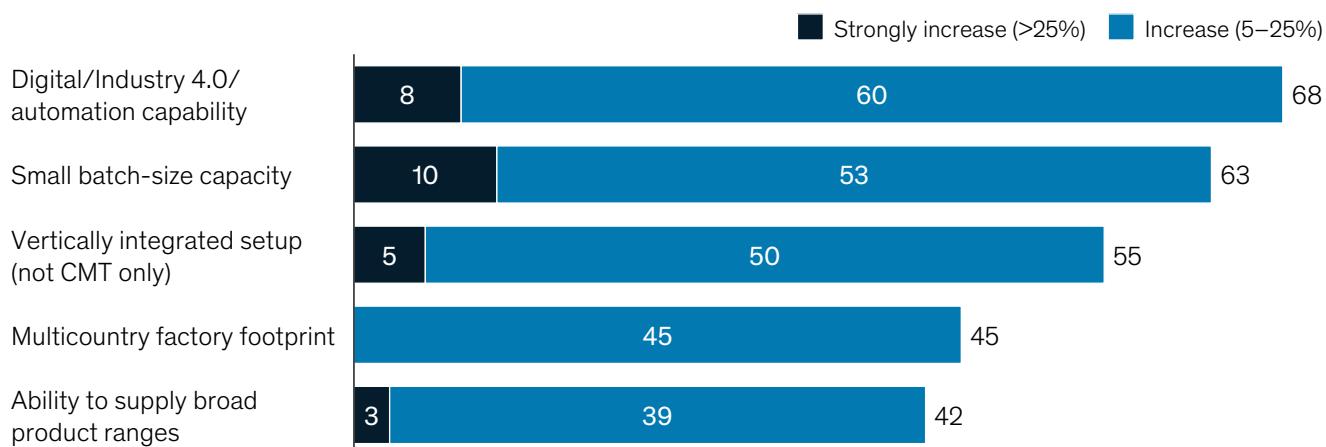
- **Multifactory footprint:** Suppliers with an international factory footprint allow brands and retailers to hedge production risks in certain countries or regions, to build "plan B" production sites, and to fulfill dual/multicountry sourcing strategies for in-season reactivity. Of the international respondents surveyed, 45 percent plan to increase, by up to a quarter, their number of suppliers with multi-country presence.

Exhibit 8

Winning suppliers are digitized and are set up to operate more efficiently and agilely

"How do you plan to develop your sourcing setup by 2025?"

Percentage of respondents on change in number of suppliers



Source: McKinsey Apparel CPO Survey 2021



Winning suppliers are digitized.

No power shift, but increased relationship quality

Even with increased demands on suppliers, real strategic partnerships remain rare. However, apparel brands and retailers are recognizing that a purely transactional relationship model is no longer fit for purpose in a demand-driven supply chain.

At the same time, competition for suppliers with a more sophisticated setup is increasing. Suppliers are also drawing their own conclusions from the pandemic disruptions; industry

associations in major sourcing countries have come together to align their expectations regarding the future buying practices of apparel brands and retailers, and relationships along the value chain.¹⁴

In recent years, movement toward closer partnerships has been noticeable. Multi-seasonal arrangements, including binding commitments and more strategic links, have gained traction since our 2019

report.¹⁵ Producers in South Asia, for example, explain that for most factories, plans for the 2023 season are already shared, or that at least MOUs have been signed for future customers.

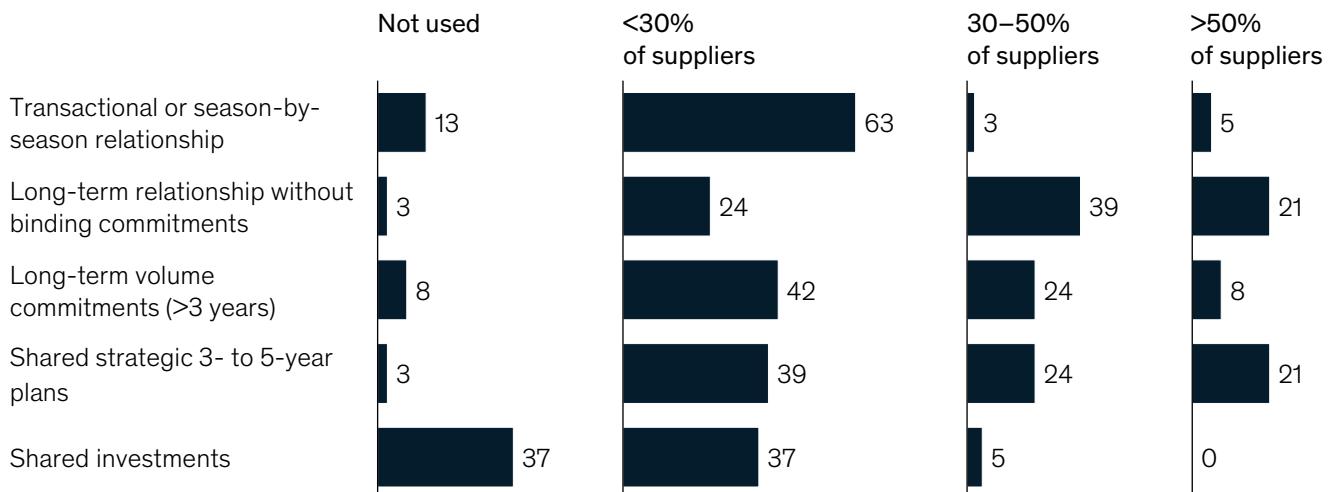
The share of suppliers joining brands and retailers in strategic investment is also growing—though this remains a relatively rare approach, reserved for best-performing, key suppliers. Less than half the survey participants plan to share investments with suppliers.

Exhibit 9

Companies plan to move towards closer supplier relationships

"How will your supplier relationships develop by 2025?"

Percentage of respondents



Note: N/A responses not displayed

Source: McKinsey Apparel CPO Survey 2021

¹⁴ "White Paper on the Definition and Application of Commercial Compliance: Sustainable Terms of Trade Initiative," Better Buying, Sustainable Textile of the Asian Region (STAR), and International Apparel Federation (IAF), September 2021, betterbuying.org/wp-content/uploads/2021/09/STTI-White-Paper-on-the-Definition-and-Application-of-Commercial-Compliance.pdf.

¹⁵ "Fashion's new must-have," 2019.

Smartening up sourcing: Digitization still has a ways to go

Much has changed on the digitization front in the last five years. When we wrote our 2017 report on digitizing sourcing, hardly any apparel brands or retailers had embarked on a holistic digital and analytics transformation program.¹⁶

At that time, the tools that companies believed would have the highest impact in the medium term (over five years) were: E2E process management, capacity planning, business and

supplier collaboration portals, design to value, and automated supplier monitoring. Virtual prototyping and 3D design were also identified as highly promising areas.

The industry has made much progress in digitization since then, with the pandemic accelerating the deployment of tools such as virtual sampling. Likewise, new supply-chain transparency and traceability solutions

have gained traction due to stronger focus on efficiency and sustainability (beyond tier one). It is abundantly clear how digitizing the value chain enables speed and flexibility, both in analytics and in process improvements.

However, when executives were asked in our current survey to rank key digitization investment areas for the period to 2025, many of the same topics led the pack: capacity planning,

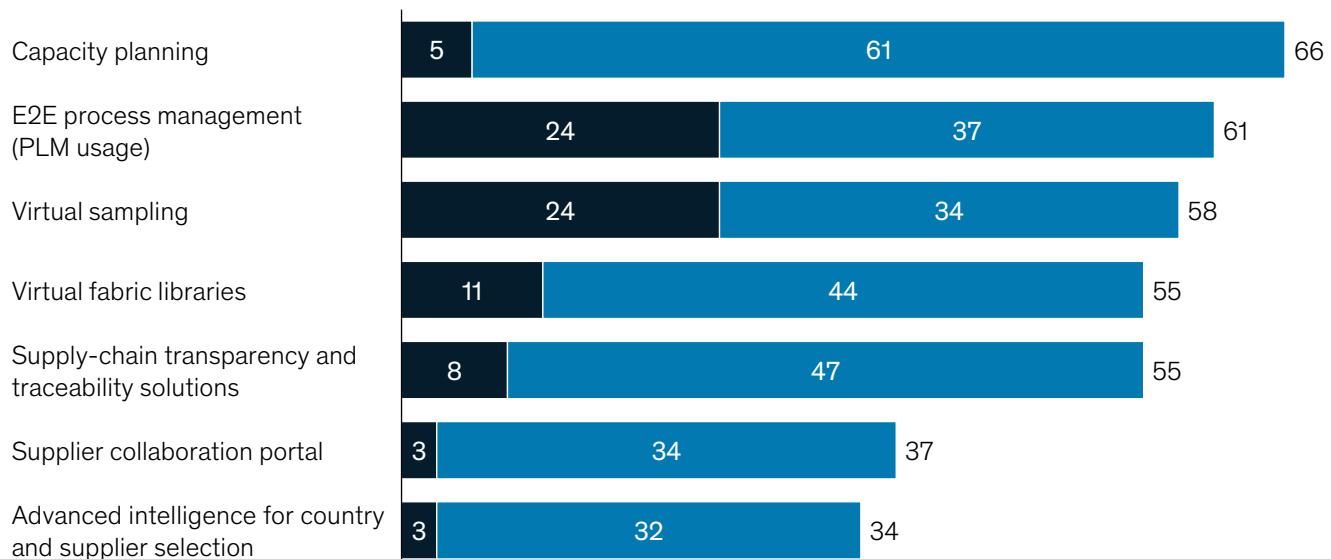
Exhibit 10

Companies still see further investment needs in areas they identified as core in 2017¹

“What are the key investment areas for digitizing your sourcing process and order management up to 2025?”

Ranking in top 5, percentage of respondents

■ Top 1 ■ Ranked as top 2 to 5



1. The apparel sourcing caravan's next stop: Digitization. McKinsey apparel CPO survey 2017

Source: McKinsey Apparel CPO Survey 2021

¹⁶ Achim Berg, Saskia Hedrich, Tim Lange, Karl-Hendrik Magnus, and Ben Mathews, “Digitization: The next stop for the apparel-sourcing caravan,” McKinsey & Company, September 2017, mckinsey.com/industries/retail/our-insights/digitization-the-next-stop-for-the-apparel-sourcing-caravan.

named in the top five by two-thirds of respondents, took first position, followed by E2E process management (61 percent of respondents). Virtual sampling, virtual fabric libraries, and supply-chain transparency and traceability were each named by more than half.

E2E process management was seen as a top goal for future digitization investment by 24 percent of executives, while a further 24 percent picked virtual sampling. Virtual fabric libraries were named as a number-one priority by one in ten respondents.

Given the current status of analytically supported, intelligent sourcing, and the increasing complexity of the flexible supply chain, it's surprising that AI for country and supplier selection is relatively low on the investment list—only in the top five for 34 percent of companies.

Investment is needed in these areas for companies to achieve their targets. In the past, we have mostly seen individual initiatives to digitize select elements, rather than full-scale transformation. However, more and more companies are recognizing that holistic digital and

analytics transformations across the company, will be crucial to enabling speed and flexibility.

Moving to a more integrated operating model

With rapid shifts in country strategies and supplier mix, and as increasingly more apparel brands and retailers embark on digitization of assortment planning, design, product development,

and sourcing, the industry faces major operational changes. Companies need to transform themselves internally to flourish in this new era, where speed and flexibility are paramount.

New roles for the sourcing office of the future

Despite the expected increase in sourcing countries, and the further reduction of agents, more than two-fifths of the companies participating in this survey plan to keep the number of sourcing offices stable. However, 16 percent plan to increase the sourcing-office footprint by at least 5 to 25 percent, and some by even more.

What is clear in this reshuffle is the decreasing importance of Hong Kong as a sourcing hub. Some surveyed companies have moved, or are planning to move, their Asian sourcing hub to alternative locations like Singapore or Bangkok. Three out of ten plan to reduce the number of full-time equivalents (FTEs) in their Hong Kong offices (including 11 percent that aim

for a staff reduction of more than a quarter).

The role of sourcing offices is changing. As digitization of standard processes frees up capacities, a fifth of companies plan to decrease the number of FTEs in their sourcing offices. Additionally, digitization enables more direct interaction between suppliers and the buyers and designers at company headquarters. Sourcing offices need to plan fewer trips for staff at headquarters to meet suppliers.

In a demand-driven model, where sourcing offices need to change gears from cost to agility and processes are becoming digitized, sourcing teams need to build up a different set of

capabilities—reskilling staff or hiring new talent accordingly. As discussed, some responsibilities for design and sample approval will move to the sourcing offices. At the same time, capacity planning and agile supply-chain management require boosted analytics capabilities, as well as relationship skills to move from a cost-negotiation focus to more relationship-focused, strategic supplier management. With the increasing focus on full-price sell-through and net-product margin rather than on cost price only, the sourcing office needs to develop these aspects of an E2E supply chain. Such shifts, together with a changing global footprint, account for the 32 percent of our respondents who plan to increase the number of FTEs in their sourcing offices.



1/2

of companies plan to decrease the number of trips of HQ buyers to Asia

New ways of working to overcome hurdles

While many challenges are expected in relationships in the ever-changing supply chain, sourcing executives anticipate that even more work will be required within their own companies to support the new sourcing model. For most companies, transforming ways of working is a major ongoing challenge, with numerous hurdles on the way to speed and flexibility.

- Given the burning issue of **digitization**, a lack of digital tools is considered the main hurdle, with 71 percent of respondents ranking it among their top-five challenges. This is accompanied by a **skills gap**

in the implementation of digital tools, taking fourth place, with mentions by five out of ten CPOs.

- Even in advanced sourcing organizations, we still see **silenced ways of working**—combined with unclear division of responsibilities, with issues at the interface of the design, merchandising and sourcing teams, as well as between the head office and overseas offices. This was named as the number-one obstacle to implementing speed and flexibility by 29 percent of respondents. These misalignments lead to bad communication and thus to delays and unnecessary costs, not just for the sourcing organization but also for suppliers. To achieve the new trajectory, sourcing, merchandizing and design departments need to be in sync and working together—be it in virtual product teams, or under one roof.
- **Speed and flexibility come at a cost.** Even with the inflationary nature of production and current global disruptions, many apparel brands and retailers still ask their sourcing organizations to meet demanding targets for

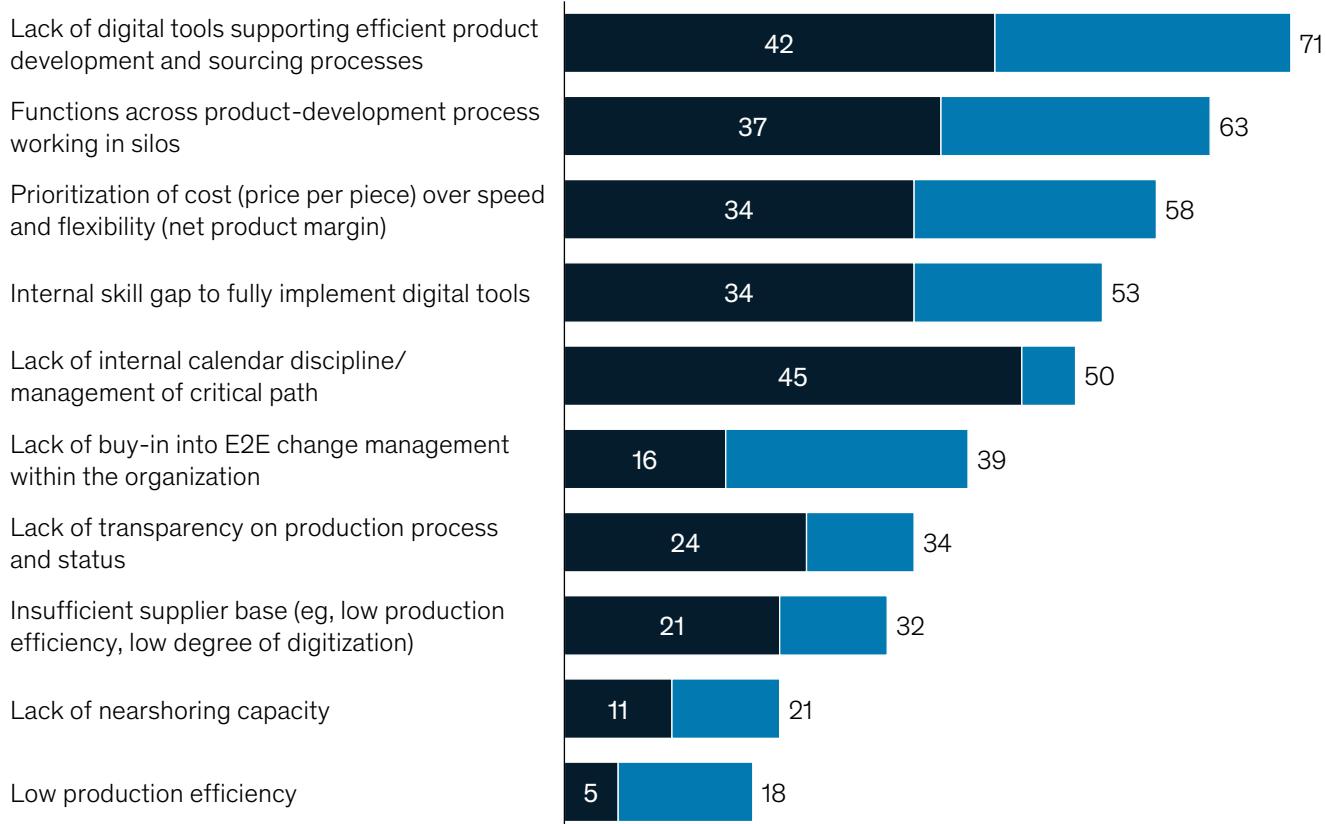
Exhibit 11

Internal obstacles to achieving speed and flexibility

“What are the main hurdles you have experienced in implementing speed and flexibility to manage demand volatility and supply risk?”

Ranking in top 5, percentage of respondents

■ Top 3



Source: McKinsey Apparel CPO Survey 2021

piece prices. Product teams still often prioritize cost over net product margin, thus hampering the transformation to a more consumer-centric supply chain. This is a top-five dilemma for 58 percent of CPOs, putting it in third place on our list. As discussed in detail in an earlier report, sourcing decision-making needs to become more intelligent, including full-price sell-through in the mix.¹⁷

- **Lack of internal calendar discipline**, the fifth most mentioned hurdle, is caused by a mix of underlying problems, ranging from overall long lead times, to a lack of segmented calendars, limited integration of consumer

insights in assortment planning, and lack of “one truth” regarding process transparency. Though few companies name this as their most significant problem, half place it in the top five. Often, this problem begins with a lack of clearly defined calendars: companies identify only a few top-level elements of the critical path, leaving long stretches of time open. Best-practice companies have moved to defining calendars at a very granular level, have deployed calendar managers, and incentivize calendar discipline. All teams involved, from product planning to launch, have clearly defined decision-making roles and responsibilities, and are held accountable to these.

Overall, accountability for E2E process efficiency, and for individual steps in the product-development process, remains an area for development. Even though many companies track various KPIs, only some use them to incentivize improvement toward clear targets. For example, 61 percent companies surveyed track sample efficiency—but only 16 percent do so with clear incentives. Order-related processes are the least tracked and incentivized. Frequency of order revisions, to take another example, is currently not tracked at all at 44 percent of companies surveyed.

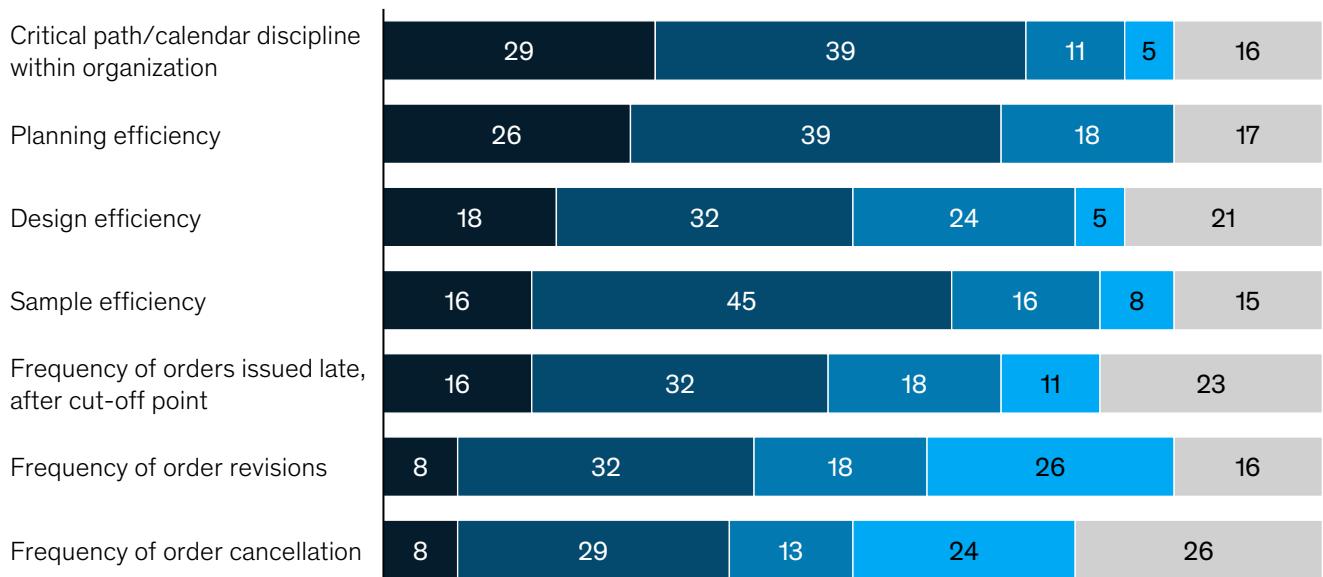
Exhibit 12

Order revisions and cancellations are the least-tracked KPIs today

“How do you incentivize your sourcing and product development organization for E2E efficiency?”

Percentage of respondents

- KPIs with clear improvement targets and incentives
- KPIs tracked, but not used for internal incentives
- Not tracked, plan to implement in next years
- Not tracked and no plan for implementation
- N/A



Source: McKinsey Apparel CPO Survey 2021

¹⁷ “Is apparel manufacturing coming home?,” 2018.

Accelerating for success

To redefine their strategy to fit new customer demands, the sourcing organization of the future will be tailored for speed and flexibility. This means a fully transformed set of tools, capabilities, and mindsets, across the organization.

Having worked intensively with apparel retailers and brands over the years, particularly through the volatile times that birthed this year's survey, the McKinsey team is able to propose a set of recommendations: strategies to help

the industry overcome the sourcing hurdles ahead, and achieve a new trajectory for success.

1. Turbocharge digital tools and capabilities



Digitization will not stop for the world of sourcing. The sourcing executives of tomorrow need to be on the forefront of this change, driving the development of abilities—and ensuring that the ownership of these tools resides in the organization. The required speed cannot be dependent on outsiders' expertise.

On top of purely technological changes, sourcing organizations often lack the knowledge, capabilities, and capacity to implement new day-to-day ways of working. Investing in internal digital upskilling, new technological developments, and other capabilities is

paramount for building the organization of the future.

While many frontrunner organizations have invested in certain digital tools and processes, very few have mastered E2E digital control to support product development. In order to trim significant time and cost from the process, a fully integrated setup will be necessary, including 3D designing, cleansheet costing, and supplier integration. Rather than focusing on implementing select tools, it's recommended that apparel companies work on full-scale digital and analytics transformation to reap success.

2. Optimize strategy for net margin



Smaller batch sizes and shorter lead times are here to stay. The organization of the future needs to define calendars and fulfillment models that still allow for healthy margins, even with ever-changing customer demands.

Many calendars currently used in sourcing organizations are too vague, or do not factor in different "swim lanes" for different product types. On top of that, organizations lack a proper drumbeat in the form of powerful calendar managers. Investing in this role, and understanding the requirements of different timelines, will unlock significant speed and flexibility in the organization. While optimizing the process itself does not lead to a better bottom line, it has been shown on multiple occasions that there is a direct link between a properly managed calendar and strong net margins.

Continuing the trend of the last decade, it will be key to develop strategic nearshoring capacities—for shorter lead times, and as risk mitigation for skyrocketing transportation costs and potential shutdowns. A clear vision of the requirements of each product type will ensure transparency regarding capacity needs.

In recent years, difficulties have surfaced in many East Asian sourcing markets, ranging from political issues to environmental and ethical concerns. It will be crucial for CPOs to understand the strengths, weaknesses, and development potentials of each of their sourcing markets, to enable shifts and set the right footprint. Setting proper guidelines and KPIs to judge markets, not just on cost but on flexibility, will help drive the change.

Sourcing offices often compete for the “right” product allocation. It is paramount that the central team make intelligent country decisions based on clear, structured rules, aiming to

maximize net product margins, not cost prices. When making such decisions, sourcing organizations should factor in the time to market, as well as potential improvements in full-price sell-through.

3. Create a (virtual) ecosystem



While the apparel industry is a long way behind the automotive or pharma sector in this regard, we have seen that investments in transparency and supplier production pay off very quickly. It is crucial to onboard suppliers onto the PLM system, and take full control over manufacturing and delivery timelines. The sourcing organization of the future should not be left in the dark about production status: this is nonnegotiable.

Future (European) laws will also necessitate the digitization of the full value chain of tier-one and tier-two suppliers; interlocking systems and sharing best practices will create full transparency further into the supply chain. In addition, customers will increasingly demand knowledge of where raw materials are milled, dyed, and

finished. Creating a digital ecosystem will not only improve speed and flexibility, but also give assurance that products are sustainable and ethically produced.

The shortages of the last months have shown that it will become more and more important to ensure sufficient and flexible raw-material supply. Elements of this strategy will include near- or reshoring, securing feedstock for sustainable fibers, and boosting a circular textile approach.

While apparel brands are still reluctant to form too many strategic partnerships through co-investments, we have seen that maintaining a set of key suppliers for important “swim lanes” can achieve the flexibility that is required, as can investing in automation capabilities.

4. Align the organization to new incentives and roles



Many organizations still struggle with competing, or at least misaligned, incentives and priorities. If the sourcing organization is purely incentivized by year-on-year cost-of-goods reduction, and the merchandizing team only by the top line, they will not pull in the same direction. We strongly believe that, from an overall margin perspective, mapping and creating joint KPIs is necessary to achieve the required shifts.

Beyond purely financial priorities, we have observed that a lack of process and planning focus, including poor calendar discipline, has long-term repercussions.

In order to achieve the required E2E alignment, we advise including these factors in organizational targets.

Lastly, the sourcing organization of the future will need to ensure focus is not simply on “the best cost price,” and rethink the responsibility split between headquarters and sourcing offices. Sourcing offices will change their role—from a focus on order management and negotiation, toward an integrated supply-chain perspective—and strengthen their skill sets in strategic supplier-relationship management, fabric management, and design and sampling.



Achieving a new trajectory based on speed and flexibility in the postpandemic era will require a full-blown transformation of apparel sourcing. To become more customer focused, and to maximize the bottom line while meeting shoppers’ needs, organizations need to focus on both internal and external factors. Keys to success will be a digitization turbocharge, as well as a full operating-model overhaul: radical changes that will jump-start the brand and keep it driving, to 2025 and beyond.

Authors



Saskia Hedrich is a senior expert at McKinsey's Munich office and a leader in the Apparel, Fashion & Luxury Group.



Julian Hügl is an associate partner at McKinsey's Stuttgart office and a core member of Operations in the Apparel, Fashion & Luxury Group.



Patricio Ibanez is a partner at McKinsey's Cleveland office and leader of the American Purchasing & Supply Management Practice.



Karl-Hendrik Magnus is a senior partner at McKinsey's Frankfurt office and leader of Operations in the global Apparel, Fashion & Luxury Group.

Acknowledgements

The authors wish to thank all the sourcing executives who took the time to participate in our survey.

We are grateful to Hendrik Zuber, an associate at the Atlanta office, for his contributions to this article.

We also thank Colin Douglas, who edited the report, and Bettina Hauber, who designed it, as well as Adriana Clemens for communications support.

If you have any queries, please contact ApparelSourcing@mckinsey.com

McKinsey Apparel, Fashion & Luxury Group

November 2021

Copyright © McKinsey & Company

Designed by Visual Media Europe

www.mckinsey.com

 @McKinsey

 @McKinsey